SUPREME COURT, U. S.

279

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In the

Supreme Court of the United States

OCTOBER TERM, 1967

No. 22,174

TURNBULL, INC., Transferee,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

WENTWORTH T. DURANT,
3434 First National Bank Building,
Dallas, Texas,

RONALD M. MANKOFF,
3434 First National Bank Building,
Dallas, Texas,
Counsel for Petitioner.

WARLICK PRESS, INC.—P. O. BOX 10543—2263 VALDINA STREET—DALLAS—ME 1-3130

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above case on March 22, 1967.

OPINIONS BELOW

The Original Memorandum Opinion of the Tax Court of the United States (T. C. Memo, 1963-335) is reported at 22 T.C.M. (CCH) 1750, and at 1963 P.H. T.C. Memo Dec.

¶63,335 (R. 578, Vol. II-III), and is reprinted at Appendix B-12. The Supplemental Opinion of the Tax Court is reported at 42 T.C. 582 (R. 544, Vol. II), and is reprinted at Appendix B-56. The opinion of the United States Court of Appeals for the Fifth Circuit (R. 784-793, Vol. IV) is reported at 373 F. 2d 91, and is reprinted at page 1 in Appendix B, hereto.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was made on February 1, 1967 (R. 795); Petition for Rehearing, duly filed on February, 1967 (R. 805), was denied and judgment was entered on March 22, 1967 (R. 813). Mandate was issued on April 7, 1967 (R. 795, Vol. IV). Copies of the Judgment and Order are reprinted at Appendix B-10, 11. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a corporation which has sold income rights to an unrelated buyer for cash and the assumption of liabilities remains taxable on that income when it is collected by the buyer under the doctrine of *Helvering v. Horst*, 211 U.S. 112 (1940).

2. Whether a transaction between unrelated corporations may be rearranged for tax purposes by the Commissioner of Internal Revenue where §482, I.R.C., 1954* is inapplicable.

3. Whether Petitioner is a "transferee at law" of H. R. Henderson & Co. so that the Commissioner need offer no evidence that any assets were transferred to Petitioner, on the grounds that:

(a) Petitioner merged with Henderson and agreed to be liable for the latter's debts as though they had been incurred directly by Petitioner;

(b) Petitioner executed a Treasury Form 2045 (Transferee Agreement), acknowledging its status as a transferee and assuming Henderson's tax obligations "to the extent of its liability under §6901"; or

(c) Petitioner is estopped to deny its liability as a transferee at law.

STATUTES AND REGULATIONS

The pertinent portions of the Internal Revenue Code of 1954 (§§61, 102, 482, 1221) and relevant Treasury Regulations appertaining thereto are set forth in Appendix A, hereto.

STATEMENT

Issue I

On April 1, 1953, when its president died, Petitioner commenced its liquidation. Its remaining directors marshalled

* All references to Code Sections shall be to the Internal Revenue Code of 1954 unless otherwise designated.

its assets, refused new business, sold some existing contracts and pressed the remaining ones to completion.

In May, its key employees asked to purchase Petitioner's corporate shell after outstanding stock interests had been redeemed. A Request for Ruling was filed to determine tax consequences to Petitioner's shareholders if this sale were made. In this July, 1953 Request for Ruling Petitioner explicitly stated its intention to sell accounts receivable for the purpose of raining $200,000 in cash. This was the additional amount necessary to complete the redemption of Petitioner's outstanding stock for cash.

Thereafter, other offers were made by competitors to purchase Petitioner's stock; all but one of these were withdrawn when the offeror learned that Petitioner was a co-defendant in lawsuits claiming over $500,000 for personal injuries and a wrongful death arising out of the collapse of a structure in South Texas. The remaining offer was conditioned on Mrs. Turnbull's indemnification against liability on these lawsuits. A $100,000 bonus was offered to her for this indemnity. Mrs. Turnbull refused.

In December, 1953, Price Construction Co. solicited the opportunity to purchase Petitioner's accounts receivable[1] for $200,000 plus assumption of liability on those lawsuits. Price's accountant, on his independent examination, estimated the face amount of these accounts to be $420,526.98.

[1] These were actually three different kinds of claims: (a) accounts receivable for completed work; (b) estimated percentages of completion on contracts in process; and (c) claims for the recovery of "retainages" held by clients subject to acceptance of the completed job. For convenience, they shall be referred to as "accounts."

Petitioner's management contemporaneously estimated that $378,000 could actually be collected on the accounts. In January, 1954, Price's Board of Directors authorized this offer for the accounts: $50,000 in cash, $150,000 on or before 90 days, and the assumption of Petitioner's liability and expenses on the South Texas lawsuits and on two other breach of contract lawsuits claiming approximately $40,000 from Petitioner.

Petitioner accepted Price's offer and, on February 4, 1954, duly assigned the accounts. Price paid the price and assumed all costs and liabilities attendant upon the South Texas lawsuits and the two breach of contract suits. This sale was approved and executed by Petitioner's directors and officers.

During this period, H. R. Henderson & Co. had been negotiating for the purchase of Petitioner's stock from Mr. Turnbull's widow and from his Estate. On January 27, 1954, they accepted Henderson's offer to purchase their stock for $975,000. This sale was consummated on February 5, 1954.

On February 4th and 5th, 1954, Henderson and Price had three shareholders in common:

Stockholder's Name	*Henderson (R. 344)*	*Price (R. 339)*
H. R. Henderson	32%	28%
Cameron McElroy, Jr.	48%	20%
B. C. McElroy	10%	10%
E. Key, III	10%	0%
E. Key Jr. (or estate)	0%	10%
John M. Henry	0%	12%
W. D. Henderson	0%	10%
Earnest S. Smith	0%	10%
TOTAL	100%	100%

No evidence of relationship between Messrs. Henderson, C. McElroy and B. C. McElroy was offered.

During the remainder of 1954 and in 1955, Price actually collected $469,608.34 on the assigned accounts and incurred $13,000 in expenses of collection. In October, 1954, the South Texas lawsuits were settled by payment of $5,000 on Petitioner's account by an insurance company which had early disclaimed coverage because of late notice. In its 1954 and 1955 income tax returns, Price reported the excess collected on the purchased accounts over its cost basis as ordinary income. It utilized its net operating loss deduction from earlier years to offset that profit. In its tax return for the period ended February 4, 1954, Petitioner reported the $200,000 then collected as ordinary income from the sale of income rights, and deducted its $41,000 cost basis in those accounts.

Issue II

From and after February 5, 1954, Petitioner filed consolidated returns with Henderson. On December 31, 1957, Henderson merged into Petitioner and the latter's name was changed from J. Gordon Turnbull, Inc., to Turnbull, Inc. The "Agreement of Merger" provided that "* * * all debts, liabilities and duties of the respective constituent corporations * * * shall thenceforth attach to the Surviving Corporation, (Petitioner) and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it."

In February, 1960, Petitioner's secretary executed a Treasury Form 2045 which stated that Petitioner was a trans-

feree of assets from Henderson and that it assumed and agreed to pay Henderson's taxes "* * * to the extent of its liability at law or in equity, as a transferee within the meaning of §6901 * * *." (R. 765).

On January 22, 1962, a Statutory Notice of Transferee Liability was mailed to Petitioner alleging its secondary liability as Henderson's transferee for the period covered by the consolidated returns. The notices alleged that Petitioner was taxable on the full $469,608.34 collected by Price during 1954 and 1955; that Henderson was liable for those taxes as the parent corporation filing consolidated returns; and that Petitioner was Henderson's transferee. Petition to the Tax Court of the United States was duly filed.

DECISIONS BELOW

The Tax Court affirmed the Commissioner's determination on the grounds that (1) Petitioner was Henderson's transferee at law so that no evidence of transferred assets or their value was necessary and (2) that Petitioner's sale to Price was between "related parties" and for the grossly inadequate consideration of $200,000, whereby the sale was not "at arm's length". The value of the income rights on February 4, 1954, was held to be equal to their estimated face amount, $420,526.98. The additional assumption of liabilities on pending lawsuits was deemed to be meaningless.

The Tax Court held that Petitioner was taxable on the full $469,608.34 actually collected by Price in 1954 and 1955, less the costs of collection incurred by Price.

Upon Petitioner's Motion for Revision of the Opinion, the Court conceded the factual error of its first conclusion that Petitioner was related to Price and determined instead that "in substance, there was no adversity between J. Gordon Turnbull, Inc., and Price Construction Co." (App. B-47).

The Court of Appeals held that Petitioner was a transferee at law by reason of the merger agreement, the Form 2045 and an estoppel and affirmed on the grounds that (a) the purpose of Petitioner's assignment was to avoid income tax; (b) the consideration for the sale was inadequate; (c) it was to the interest of the three individual shareholders who controlled both Henderson and Price that Price collect these accounts since it had a large net operating loss; and (e) the transaction was invalid for tax purposes because it was not an arm's length agreement.

The Court concluded that

> "A taxpayer-corporation which has earned the right to income to be paid in the future cannot escape the tax on those earnings merely by transferring the right to income to another corporation. *Wood Harmon Corp. v. United States*, 2 Cir. 1963, 311 F. 2d 918. See also *Helvering v. Eubank*, 311 U.S. 122, 61 S. Ct. 149, 85 L. Ed. 81 (1940); *J. Ungar, Inc. v. Commissioner*, 2 Cir. 1957, 244 F. 2d 90." (R. 792-93)

REASONS FOR GRANTING THE WRIT

Issue I

The Court of Appeals for the Fifth Circuit has decided a question of Federal law in a way which conflicts with the applicable decisions of this Court.

This Court has created two distinct rules, both of which have come to be known as "anticipatory assignment of income". Under the first rule, established in *Helvering v. Horst*, 311 U.S. 112 (1940), the gratuitous assignment of income rights to the natural object of a donor's bounty will not relieve the donor of tax liability when that income is later collected by the donee. The donor's *realization* of income, an essential factor under our system of taxation, is deemed to flow from his vicarious economic enjoyment of the donee's prosperity. Here, the question is "who" is to pay the tax. *Cf. Blair v. Comm'r*, 300 U.S. 5 (1937).

A completely different concept involving the sale rather than the gift of income rights was the subject of *Comm'r v. P. G. Lake, Inc.*, 356 U.S. 260 (1958). There, such a sale between a corporation and its president was held not to qualify for capital gains treatment because income rights were not capital assets. Nevertheless, the seller was taxed only on the gain he realized from the sale; the buyer was taxed on its collections of income in excess of the price paid. The close relationship between buyer and seller in the *Lake* case was apparently no more relevant than it would have been in construing the sale of any asset. The only question was the nature of the seller's profit on the sale.

As the author of these concepts, this Court has consistently reviewed cases of gratuitous assignment to objects of the assignor's natural bounty, including corporate distributions to shareholders. *Eg., Helvering v. Clifford*, 309 U.S. 331 (1940); *Helvering v. Eubank*, 311 U.S. 122 (1940); *Harrison v. Schaffner*, 312 U.S. 579 (1941); *United States v. Joliet & Chicago R. Co.*, 315 U.S. 44 (1942).

Similarly, this Court has accepted the responsibility for policing the concept that proceeds realized on the sale of "income rights" constitute a presently taxable substitute for that future income. *Eg., Hort v. Comm'r*, 313 U.S. 28 (1941); *Watson v. Comm'r*, 345 U.S. 544 (1953); *Cf., Comm'r v. Gillette Motor Transport, Inc.*, 364 U.S. 130 (1960).

Perhaps it was unavoidable that these two theories of taxation should be confused and their rationale commingled. That is the case here.

Petitioner sold "income rights." On a sale, *Lake* should apply. However, because the purchase price proved to be substantially less than the collections ultimately received by the buyer, the courts below applied *Horst*. The evidence shows that collections were higher than either party anticipated and, conversely, the purchase price was lower than expected; a contingent element of the purchase price proved to be of no value. But even if a "bargain purchase" had been *intended*, it would create income for Price, not Petitioner (Reg. 1.61-2(d) (2)). *Horst* cannot shift income realization in the absence of some existing relationship.

This attempt by the Commissioner to extend his power to ignore legal rights established by a taxpayer's enforceable contracts and the rights conferred by the ownership of property is not premised upon §482. That provision, which constitutes the Commissioner's sole statutory authority for allocating income between business entities to correctly reflect their income, was not claimed and therefore was not applicable;[2] neither was there such common control between the taxpayers at the time of Petitioner's sale to Price as could allow its application.[3] The Commissioner is not relying on sham, or disregard of a corporate entity to sustain his taxation to Petitioner of income owned and collected by Price. This Court has consistently struck down his attempts to claim authority to reconstruct enforceable transactions or to ignore operating corporations. E.g., *Gregory v. Helvering*, 293 U.S. 465 (1935); *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436 (1943); *Comm'r v. Tower*, 327 U.S. 280 (1946); *National Carbide Corp. v. Comm'r*, 336 U.S. 422 (1949). Rather, in this case, the Commissioner's authority for recasting this completed sale between strangers in interest was grounded upon the misapplication of this Court's doctrine of anticipatory assignment as stated in *Horst*.

The Tax Court allowed this result because, it claimed, the *Lake* rule could apply only to a sale "at arm's length." The real question is whether *Horst* applies to a sale be-

[2] *Comm'r v. Chelsea Products Bureau*, 197 F. 2d 620 (3rd Cir. 1952)

[3] *Rooney v. United States*, 305 F. 2d 681 (9th Cir. 1962); control means "power" not merely "influence", G.C.M. 2856, VII-1 C.B. 128, 130; joint control between unrelated taxpayers will not suffice, *Lake Erie & Pitts. R. Co.*, 5T.C. 588 (1945).

tween unrelated parties. This decision was affirmed because a reduction in tax on income already "earned" would otherwise result. Of course, this reduction in tax flowed from Price's net operating loss deduction and not from Petitioner's sale.

Unless this Court refutes the misapplication of its *Horst* rule, *Turnbull, Inc. v. Comm'r* will stand for the proposition that any sale of accounts may be reconstructed if actual collections exceed the purchase price. The seller will be taxed on money legally in the hands of the buyer. No suggestion has been offered of the tax-nature of the buyer's "acquisition" of those monies which have been taxed to seller. This confusion is not justified because of a "bad business deal". In deciding a case contrary in principle to the decision reached below, Chief Judge Jones of the U.S. Court of Claims has said

> "* * * It is not clear to us just what standards of 'horse trading' the Government would have us impose on the business community before we could say that a valid and binding sale had occurred." *Arnfeld v. United States*, 163 F. Supp. 865, 867 (Ct. Cl., 1958).

Other decisions conflicting in principal are these: *Rhode's Estate v. Comm'r*, 131 F. 2d 50 (6th Cir. 1942); *Bell's Estate v. Comm'r*, 137 F. 2d 454 (8th Cir. 1943); *McAllister v. Comm'r*, 157 F. 2d 235 (2nd Cir. 1946); *Jones v. Comm'r*, 306 F. 2d 292 (5th Cir. 1962). In each of these cases, the sale of income rights to non-strangers resulted in the seller's taxation on the price received only, albeit at ordinary income rates rather than the capital gains rates claimed by the taxpayers.

The Sixteenth Amendment to the Constitution of the United States authorizes the taxation of income. To be subject to taxation, however, income must be *realized* by the taxpayer. *Eisner v. Macomber*, 252 U.S. 189 (1920). The Courts below have offered no suggestion as to how income collected and owned by Price could be deemed to have been *realized* by Petitioner. Since it enjoyed no economic satisfaction as a result of Price's collections, the doctrine of *Horst* cannot apply.

Issue II

The Court of Appeals has rendered a decision on the important Federal question of transferee liability "at law" which has not been but should be settled by this Court and has applied a doctrine of quasi-estoppel in conflict with the decisions of other Courts of Appeal on the same matter.

Petitioner's liability for Henderson's tax deficiency was determined to be secondary only, as a transferee and under the authority of §6901, I.R.C., 1954. That section was added to clarify the procedural rights of the government under local laws which have always fixed the substance of transferee liability. *Phillips v. Comm'r*, 283 U.S. 589 (1931). Section 6901 refers only to the method of enforcing "the liability, at law or in equity, of a transferee of property", §6901 (a) (1) (A).

"Legal transferee liability" is a misnomer which has been attached to the contractual assumption of tax liability. It is not "transferee' liability at all. And, since contractual liability has no relationship to the value of transferred assets

and is not dependent on the insolvency of the transferee, proof of those requisites to true "transferee liability' are not deemed essential. On the other hand, true transferee liability flows from the uncompensated-for transfer of assets which renders the transferor insolvent. The transferee's liability is limited to the value of assets received. The Commissioner has the burden of proving that Petitioner is liable as a transferee of property of a taxpayer. §6902 (a). This was not the subject of proof or findings below.

The Tax Court relied upon Petitioner's execution of the Form 2045 to support its decision.[4] The Court of Appeals claimed reliance on the Merger Agreement, the Form 2045 and an estoppel. The Merger Agreement executed by Petitioner created primary liability only for Henderson's debts. *Oswego Falls, 26 B.T.A.* 60 (1932), aff'd 71 F. 2d 673 (2nd Cir. 1934). It contained no assumption of liability notwithstanding the Court of Appeal's opinion that "shall attach" means "are assumed" (App. B-7).

The execution of the Form 2045 (Transferee Agreement) does not relieve the Commissioner of the burden of proving the actual transfer of assets to the transferee and the value of those assets. *Blanche Rosenzweig*, T.C. Memo, 1955-67. Otherwise, the extent of liability "as a transferee under §6901" described in that form is not established. The Commissioner offered no such proof below.

[4] In *Missile Systems Corporation of Texas*, T.C. Memo 1964-212, the same judge held a merger agreement did not create transferee liability and distinguished *Turnbull, Inc.* on the ground that Petitioner had executed the Form 2045.

On the question of estoppel, there is a conflict between the Circuits. In some circuits, a quasi-estoppel doctrine has been applied to prevent a Petitioner from denying the binding effect of a Revenue Form even though the form does not purport to be binding as a contract. Other circuits have refused to find an estoppel in the absence of taxpayer's actual misrepresentation of material fact and the government's reliance on that misrepresentation.

In this case, the Court of Appeals cited *inter alia, Daugette v. Patterson*, 250 F. 2d 753 (5th Cir. 1957), *cert. den.* 356 U.S. 902 (1958). That case relied on estoppel to bind a taxpayer. The United States Court of Appeals for the Eighth Circuit and the Court of Claims have also held that an estoppel may apply against taxpayers who do no more than execute a Treasury form on which the government relies.[5] A contrary rule is applied in the Second, Third, Sixth, Ninth and Tenth Circuits. These Courts require that the requisites of an estoppel actually exist. If these requisites are not present, they apply the rule of *Botany Mills.*[6] *Uinta Livestock Corp. v. U. S.*, 355 F. 2d 761 (10th Cir. 1966).[7]

In this case, Petitioner made no false representation of fact to the Commissioner. Petitioner was not Henderson's

[5] *H. W. Nelson Company v. United States*, 308 F. 2d 950, (Ct.Cl. 1962); *Cain v. United States*, 255 F. 2d 193, (8th Cir. 1958); *Cf. Girard v. Gill*, 243 F. 2d 166 (4th Cir 1957).

[6] *Botany Worsted Mills v. United States*, 278 U.S. 282 (1929), which held that no Treasury Form short of a closing agreement barred a taxpayer's suit for refund.

[7] *United States v. Prince*, 348 F. 2d 746 (2nd Cir. 1965); *Bank of New York v. United States*, 170 F. 2d 20 (3rd Cir. 1948); *Joyce V. Gentsch*, 141 F 2d 891 (6th Cir. 1944); *Van Antwerp v. United States*, 92 F. 2d 871 (9th Cir. 1937).

transferee in the context which creates secondary liability, and all of the facts establishing that conclusion were known to the Commissioner.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

June ...., 1967.

Wentworth T. Durant

Ronald M. Mankoff

CERTIFICATE OF SERVICE

The undersigned certifies that service of this Petition has been made on counsel for Respondent and the Solicitor General by deposit in the United States Mail, duly addressed, with proper air mail postage attached.

Wentworth T. Durant

June ...., 1967

APPENDIX A

Sec. 61. Gross Income Defined.

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

Sec. 102. Gifts and Inheritances.

(a) GENERAL RULE.—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

(b) INCOME—Subsection (a) shall not exclude from gross income—

(1) the income from any property referred to in subsection (a); or

(2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

Where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting, or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property. Any amount included in the gross income of a beneficiary under subchapter J shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property.

Sec. 482. Allocation of Income and Deductions among Taxpayers.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.

Sec. 1221. Capital Asset Defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by—

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

Regulations

§ 1.61-1. Gross income.—(a) *General definition.* Gross income means all income from whatever source derived, unless excluded by law. Gross income includes income realized in any form, whether in money, property, or services. Income may be realized, therefore, in the form of services, meals, accommodations, stock, or other property, as well as in cash. Section 61 lists the more common items of gross income for purposes of illustration. For purposes of further illustration, § 1.61-14 mentions several miscellaneous items of gross income not listed specifically in section 61. Gross income, however, is not limited to the items so enumerated.

* * * * *

Regulations

§ 1.61-6. Gains derived from dealings in property.—(a) *In general.* Gain realized on the sale or exchange of property is included in gross income, unless excluded by law. For this purpose property includes tangible items, such as a building, and intangible items, such as goodwill. Generally, the gain is the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged. The specific rules for computing the amount of gain or loss are contained in section 1001 and the regulations thereunder. When a part of a larger property is sold, the cost or other basis of the entire property shall be equitably apportioned among the several parts, and the gain realized or loss sustained on the part of the entire property sold is the difference between the selling price and the cost

or other basis allocated to such part. The sale of each part is treated as a separate transaction and gain or loss shall be computed separately on each part. Thus, gain or loss shall be determined at the time of sale of each part and not deferred until the entire property has been disposed of. This rule may be illustrated by the following examples:

* * * * *

Regulations

§ 1.02-1. Gifts and inheritances—(a) *General rule.* Property received as a gift, or received under a will or under statutes of descent and distribution, is not includible in gross income, although the income from such property is includible in gross income. An amount of principal paid under a marriage settlement is a gift. However, see section 71 and the regulations thereunder for rules relating to alimony or allowances paid upon divorce or separation. Section 102 does not apply to prizes and awards (see section 74 and § 1.74-1) nor to scholarships and fellowship grants (see section 117 and the regulations thereunder).

(b) *Income from gifts and inheritances.* The income from any property received as a gift, or under a will or statute of descent and distribution shall not be excluded from gross income under paragraph (a) of this section.

(c) *Gifts and inheritances of income.* If the gift, bequest, devise, or inheritance is of income from property, it shall not be excluded from gross income under paragraph (a) of this section. Section 102 provides a special rule for the treatment of certain gifts, bequests, devises, or inheritances which

by their terms are to be paid, credited, or distributed at intervals. Except as provided in section 663(a)(1) and paragraph (d) of this section, to the extent any such gift, bequest, devise, or inheritance is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property. Section 102 provides the same treatment for amounts of income from property which is paid, credited, or to be distributed under a gift or bequest whether the gift or bequest is in terms of a right to payments at intervals (regardless of income) or is in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income, they are not to be excluded under section 102 from the taxpayer's gross income.

(d) *Effect of subchapter J.* Any amount required to be included in the gross income of a beneficiary under sections 652, 662, or 668 shall be treated for purposes of this section as a gift, bequest, devise, or inheritance of income from property. On the other hand, any amount excluded from the gross income of a beneficiary under section 663(a)(1) shall be treated for purposes of this section as property acquired by gift, bequest, devise, or inheritance.

(e) *Income taxed to grantor or assignor.* Section 102 is not intended to tax a donee upon the same income which is taxed to the grantor of a trust or assignor of income under section 61 or sections 671 through 677, inclusive.

* * * * *

Regulations

§ 1.1221-1. Meaning of terms.—(a) The term "capital assets" includes all classes of property not specifically excluded by section 1221. In determining whether property is a "capital asset", the period for which held is immaterial.

(b) Property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 167 and real property used in the trade or business of a taxpayer is excluded from the term "capital assets". Gains and losses from the sale or exchange of such property are not treated as gains and losses from the sale or exchange of capital assets, except to the extent provided in section 1231. See § 1.1231-1. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23(l) of the Internal Revenue Code of 1939 before its amendment by section 121(c) of the Revenue Act of 1942 (56 Stat. 819). However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the provisions of subchapter P (section 1201 and following), chapter 1 of the Code.

(c) A copyright, a literary, musical, or artistic composition, and similar property are excluded from the term "capital assets" if held by a taxpayer whose personal efforts created such property, or if held by a taxpayer in whose hands the

basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property. As to the application of section 1231 to the sale or exchange of such property held by such a taxpayer, see § 1.1231-1. For purposes of section 1221(3), the phrase "similar property" includes, for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection (whether under statute or common law), but does not include a patent or an invention, or a design which may be protected only under the patent law and not under the copyright law.

(d) Section 1221(4) excludes from the definition of "capital asset" accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of stock in trade or inventory or property held for sale to customers in the ordinary course of trade or business. Thus, if a taxpayer acquires a note receivable for services rendered, reports the fair market value of the note as income, and later sells the note for less than the amount previously reported, the loss is an ordinary loss. On the other hand, if the taxpayer later sells the note for more than the amount originally reported, the excess is treated as ordinary income.

APPENDIX B

In the
UNITED STATES COURT OF APPEALS
For the Fifth Circuit

No. 22174

TURNBULL, INC., TRANSFEREE
(Formerly J. Gordon Turnbull, Inc.),

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the Tax Court of the United States (Texas Case).

(February 1, 1967.)

Before RIVES, WISDOM and AINSWORTH, Circuit Judges.

AINSWORTH, Circuit Judge: This taxpayer's petition for review of an adverse decision of the Tax Court involves a complicated set of facts in which three corporations, J. Gordon Turnbull, Inc., taxpayer, H. R. Henderson and Company and Price Construction Company, as well as two individuals, Cameron McElroy, Jr. and H. R. Henderson, are the principal participants.

The story begins chronologically with the incorporation of J. Gorden Turnbull, Inc. (JGT) under the laws of Ohio in August 1941. The corporation was authorized to furnish engineering, architectural and construction management services in connection with the building of large structures. Its controlling stockholder, president and chief executive was J. Gordon Turnbull, who died on April 1, 1953.

H. R. Henderson and Company (Henderson), a Texas corporation, was organized on January 3, 1946 and continued in existence through December 31, 1957, when it was merged into its subsidiary, J. Gordon Turnbull, Inc., and the name of the surviving corporation was changed to Turnbull, Inc. (taxpayer). Price Construction Company (Price), a Texas corporation, was organized on May 1, 1948.

On December 15, 1953, Henderson's Board of Directors authorized its president, Cameron McElroy, Jr., to investigate the possibility of purchasing the stock of JGT.[1] On December 18, 1953, Price Construction Company authorized Ernest F. Smith to investigate the possible purchase of JGT's accounts receivable and of assuming certain potential tort liabilities. Smith made an investigation, discussing the possible tort liabilities of JGT with attorneys for various defendants, and reported to Price on January 15, 1954 that he believed the cases could be disposed of for a reasonable amount.

On January 27, 1954, Mrs. Turnbull, individually, and on behalf of the Estate of J. Gordon Turnbull, accepted an offer of B. C. McElroy and Cameron McElroy to purchase

[1] The stock was owned by the Estate of J. Gordon Turnbull and his widow, Mrs. Susan Turnbull.

all of the outstanding shares of JGT for the sum of $975,000. Pursuant to this agreement, Henderson acquired all of the outstanding shares of JGT and the funds were provided by borrowing $25,000 from Cameron McElroy and H. R. Henderson, $801,108.37 from JGT, and by JGT redeeming stock in the sum of $148,891.63 as treasury shares, a total of $975,000, which was paid to Mrs. Turnbull and the Estate for the stock.

At the time, in fact from December 31, 1946 through April 15, 1958, the outstanding stock of Henderson was owned by H. R. Henderson, 32 per cent; Cameron McElroy, Jr., 48 per cent; B. C. McElroy, Sr., 10 per cent; and E. Key, III, 10 per cent.

On February 4, 1954, Price purchased the JGT accounts receivable of $420,526.98 by paying $50,000 cash plus a 90-day promissory note for $150,000 with interest at 4 per cent, a total of $200,000, plus assumption of any liability determined against JGT as the result of (1) a claim for damages pending in a federal court in Arkansas in the sum of $3,950; (2) a claim for damages in the amount of $38,250; and (3) a claim for damages growing out of an accident at the Reynolds Metals plant at Gregory, Texas, on November 15, 1951, in the aggregate amount of $532,895. The $50,000 cash paid to JGT was loaned to Price by H. R. Henderson and Cameron McElroy, each putting up the sum of $25,000.

The claims which Price assumed in the Gregory, Texas, accident on November 15, 1951 grew out of suits for damages for the death of a worker and the injury of seven others. JGT was the architectural engineer on the job and

responsible for drawing the plans for the design of the entire plant but did not draw the plans for the silo on which the accident occurred and on which construction was being made at the time by a subcontractor. Sued with JGT were the joint venture general contractors, H. R. Henderson and Company and Henry C. Beck Company, as well as Reynolds Metals Company, the landowner. JGT had public liability insurance, and one of its insurance carriers paid $5,000 on its behalf on November 1, 1954 in full settlement of JGT's liability in all the claims. Nothing was ever paid by either JGT or Price to settle these claims.[2]

The suit in the federal court in Arkansas for $3,950 was dismissed for lack of prosecution on March 19, 1954.

After selling its accounts receivable to Price, JGT collected the amounts due on these accounts at various times from February 1954, month by month, to February 1955, a total of $469,608.34 which was transmitted to Price as received.[3] Price then made payments to JGT on its $150,000

[2] More complete details of these suits are found in our opinion in the companion case of J. Gorden Turnbull, Inc., petitioner, v. Commissioner of Internal Revenue, respondent, No. 22173, filed this day.

[3] The total payments which JGT received and transmitted to Price are set forth as follows:

Total Payments Received During	*Amount*
February 1954	$ 85,976.37
March 1954	82,480.12
April 1954	49,202.68
May 1954	60,500.27
June 1954	115,449.45
July 1954	3,077.61
August 1954	24,400.00
December 1954	2,690.75
January 1955	2,500.00
February 1955	43,331.09
Total	$469,608.34

note beginning in February 1954, with final payment in August 1954.[4] Thus Price had paid its promissory note obligation to JGT in full within six months of the execution of the note and the purchase of the accounts receivable.

The history of the ownership of the stock of Price is pertinent and shows that as of April 17, 1952 and until August 26, 1952, Cameron McElroy was owner of 49.83 per cent, with B. C. McElroy owner of .17 per cent, a total of 50 per cent, and the other 50 per cent was owned by W. R. Price, 49.83 per cent, and Marvin Pound, .17 per cent. On August 26, 1952, Cameron McElroy purchased the outstanding 50 per cent of the stock owned by W. R. Price and Marvin Pound, and on September 19, 1952, the Price stock was redistributed, with Cameron McElroy owning 49.83 per cent; B. C. McElroy, 9.67 per cent; H. R. Henderson, 28.50 per cent, and several other smaller holdings. Thereafter Cameron McElroy purchased the outstanding stock of a number of the smaller shareholders and the stock was redistributed again on December 1, 1953 so that Cameron McElroy owned 20 per cent; B. C. McElroy, 10 per cent; H. R. Henderson, 28 per cent, with other shareholders. This percentage of ownership remained through February 4, 1954.

[4] Price payments to JGT are detailed as follows:

February 17, 1954	$ 50,000.00
April 5, 1954	25,000.00
April 28, 1954	25,000.00
May 26, 1954	5,000.00
June 7, 1954	15,000.00
June 24, 1954	15,000.00
July 2, 1954	10,000.00
August 4, 1954	5,000.00
Total	$150,000.00

Also most pertinent to this case is the fact that Price had been in financial difficulties for several years and had substantial net operating losses of $100,450.20, $41,319.73 and $108,818.13 for each of its three fiscal years ended April 30, 1951, 1952 and 1953, respectively. These losses were carried forward and offset against the JGT receivables collected and Price was able to realize this income entirely tax free. Price used these funds to repay previous advances made by Henderson to carry on its operations.

TRANSFEREE LIABILITY

The Tax Court held that taxpayer was liable as transferee for deficiencies determined to be due from Henderson for 1954-1955. During those years Henderson filed a consolidated income tax return with its subsidiary, JGT. Under the Internal Revenue Code of 1954, when consolidated returns are filed, the affiliated companies consent to the applicable regulations as provided by Section 1502 (see Section 1.1502-12(b), Income Tax Regulations) and under the Regulations the common parent and each subsidiary are severally liable for the tax for the consolidated period, including any deficiency. See Section 1.1502-15(a). Thus Henderson, the parent corporation, in whose name the consolidated returns were filed, was liable for the entire amount of tax due, including any deficiency and the affiliated corporation (JGT) was similarly liable. Turnbull, Inc. (taxpayer) is the transferee of the assets of Henderson and assumed all of its debts and liabilities as a result of the statutory merger. The merger agreement provided (Article XI(d)(e)) that "all property, real, personal and mixed * * * shall be

vested in the surviving corporation without further act or deed." And, "that all rights of creditors * * * shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations, including liability to dissenting shareholders, shall thenceforth *attach* to the Surviving Corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it." (Emphasis supplied.) In our opinion the word "attach," as used in this context, means that all liabilities of transferor are "assumed" by the transferee.

Turnbull, Inc., the surviving corporation, also executed a transferee agreement on Internal Revenue Service Form 2045 in consideration of the Commissioner not issuing a statutory notice of deficiency and making an assessment against transferor Henderson. In the transferee agreement Turnbull, Inc. specifically admitted it was the transferee of assets received from the transferor corporation (Henderson) and assumed and agreed to pay the federal income taxes for the years 1954, 1955 and 1956, in accordance with Section 6901.[5]

[5] The transferee agreement on Form 2045 reads in pertinent part as follows:

> "In consideration of the Commissioner of Internal Revenue not issuing a statutory notice of deficiency to and making an assessment against the above-named transferor corporation, the undersigned admits that it is the transferee of assets received from said transferor corporation, and assumes and agrees to pay the amount of any and all Federal income, excess-profits, or profits taxes finally determined or adjudged as due and payable by the above-named transferor corporation for the taxable year (or years) ended *1954, 1955 and 1956*, to the extent of its liability at law or in equity, as a transferee within the meaning of Section 6901 of the Internal Revenue Code of 1954 and corresponding provisions of prior internal revenue laws;"

Thus Turnbull, Inc. is bound by contract by the merger agreement and also by the transferee agreement, neither of which it may now denounce as invalid, for it is as clear as words can make it that taxpayer assumed Henderson's liability and is estopped to contend otherwise. See Section 6901, Internal Revenue Code of 1954; *Daugette v. Patterson*, 5 Cir., 1957, 250 F. 2d 753; *R. H. Stearns Co. v. United States*, 291 U.S. 54, 54 S. Ct. 325, 78 L. Ed. 647 (1934). See also *Texsun Supply Corp. v. Commissioner*, 17 T.C. 433 (1951); *Kaufmann Dept. Stores, Etc. v. Commissioner of Int. R.*, 3 Cir., 144 F. 2d 776, affirming 2 T.C. 656 (1943).

LIABILITY FOR INCOME TAX ON ACCOUNTS RECEIVABLE ASSIGNED TO PRICE

We agree with the Tax Court that the principal purpose of the assignment by JGT of $420,000 of accounts receivable for a consideration of only $200,000 was to avoid income tax that would be due upon their collection. There was no doubt about the collectibility of the accounts receivable. Cameron McElroy, Jr., B. C. McElroy, Sr. and H. R. Henderson controlled both the Henderson and Price corporations. It was to their interest to have these accounts assigned to a corporation (Price) with large net operating loss carryovers and thereby reduce the income of JGT to avoid the tax which would be due on their collection. This transparent transaction cannot be used to defeat the tax which is clearly due on the collection of these accounts. It was in no way an arms-length agreement and therefore invalid for tax purposes. The purchase by Henderson of all of JGT's stock and the assignment of JGT's receivables to Price were all

part of one transaction. To argue otherwise is to ignore the obvious. From the proceeds of the receivables Price was able to pay its $150,000 note to Turnbull within six months after the assignment was made. The sale, therefore, of the receivables by JGT to Price was for a wholly inadequate consideration manipulated in order to defeat and avoid taxes justly due thereon which properly should be taxed to JGT rather than to Price. A taxpayer corporation which has earned the right to income to be paid in the future cannot escape the tax on those earnings merely by transferring the right to income to another corporation. *Wood Harmon Corp. v. United States*, 2 Cir., 1963, 311 F. 2d 918. See also *Helvering v. Eubank*, 311 U.S. 122, 61 S. Ct. 149, 85 L. Ed. 81 (1940); *J. Ungar, Inc. v. Commissioner*, 2 Cir., 1957, 244 F. 2d 90.

The Tax Court's holding in this case is, therefore, in all respects

AFFIRMED.

B-10

UNITED STATES COURT OF APPEALS
For the Fifth Circuit

October Term, 1966

No. 22174

D. C. Docket No. 1285-62.

TURNBULL, INC., Transferee (Formerly J. Gordon Turnbull, Inc.),

Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the Tax Court of the United States (Texas Case).

Before RIVES, WISDOM and AINSWORTH, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the petition of Turnbull, Inc., Transferee (Formerly J. Gordon Turnbull, Inc.), for review of a decision of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

February 1, 1967

Issued as Mandate: Apr. 7, 1967

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In the
UNITED STATES COURT OF APPEALS
For the Fifth Circuit

No. 22174

TURNBULL, INC., Transferee (Formerly J. Gordon Turnbull, Inc.),

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the Tax Court of the United States (Texas Case).

(March 22, 1967)

ON PETITION FOR REHEARING

Before RIVES, WISDOM and AINSWORTH, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing in the above cause be, and the same is hereby, DENIED.

T. C. Memo 1963-335

TAX COURT OF THE UNITED STATES

TURNBULL, INC., Transferee[1] (Formerly J. Gordon Turnbull, Inc.),

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos. 1285-62, 95189. Filed December 24, 1963.

Leslie C. Hackler, Jr., and *Wentworth T. Durant*, for the petitioners.

Charles B. Sklar, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DAWSON, *Judge*: Respondent determined deficiencies in the income tax of petitioners, as follows:

Turnbull, Inc., Transferee

Year	*Deficiency*
1954	$127,354.99
1955	30,547.50

Price Construction Company

Taxable Year Ended	*Deficiency*
April 30, 1958	$19,788.36

[1] Consolidated herewith for trial and opinion is the proceeding of Price Construction Co., Docket No. 95189.

In the case of Turnbull, Inc., Transferee, Docket No. 1285-62, the petitioner claims overpayments for the years 1954 and 1955 in the amounts of $12,700.78 and $3,209.43 respectively.

The parties have settled some issues by stipulation which will be given effect under Rule 50. The issues remaining for decision are:

1. Is Turnbull, Inc., liable as transferee for deficiencies determined as due for the years 1954 and 1955 from H. R. Henderson & Company, transferor?

2. Are collections received during 1954 and 1955 on accounts receivable sold to Price Construction Company taxable to J. Gorden Turnbull, Inc., and includable in the consolidated taxable income of H. R. Henderson & Company and affiliate for each of those years?

3. Was the respondent's adjustment decreasing the 1954 consolidated taxable income of H. R. Henderson & Company and J. Gordon Turnbull, Inc., in the amount of $5,211.83 correct?

4. Are claimed deductions for legal and professional services in the consolidated return of H. R. Henderson & Company and J. Gorden Turnbull, Inc., for 1954 ordinary and necessary business expenses?

5. Is Price Construction Company entitled to a net operating loss deduction in its fiscal year ended April 30, 1958, as a result of a net operating loss carry forward from its fiscal year ended April 30, 1953?

FINDINGS OF FACT.

Some of the facts have been stipulated and are so found. The stipulation of facts and exhibits attached thereto are incorporated herein by reference.

J. Gordon Turnbull, Inc., was organized under the laws of the State of Ohio in August 1941 and maintained its home office in Cleveland, Ohio. The principal source of income of J. Gorden Turnbull, Inc., was from fees received for engineering, architectural, and construction management services rendered in connection with the building of military bases, manufacturing plants, and other large structures. J. Gordon Turnbull was the controlling stockholder, president and general manager of the corporation until his death in April 1953. After a statutory merger on December 31, 1957, in which J. Gordon Turnbull, Inc., absorbed H. R. Henderson & Company, the surviving corporation's name was changed to Turnbull, Inc.

H. R. Henderson & Company was a corporation organized under the laws of the State of Texas on January 3, 1946. It maintained its principal office in Marshall, Texas, and engaged primarily in highway construction. H. R. Henderson & Company was in existence through December 31, 1957, when it was merged into its subsidiary, J. Gordon Turnbull, Inc.

Price Construction Company was incorporated under the laws of the State of Texas on May 1, 1948, and maintained its principal place of business in Marshall, Texas. Price Construction Company was engaged in general contracting.

These corporations maintained their books and records and elected to report their income for income tax purposes as follows:

Corporation	*Accounting Method*	*Reporting Year*
H. R. Henderson & Company	Cash	Calendar
J. Gordon Turnbull, Inc.	Cash	Fiscal, Nov. 30
Turnbull, Inc., (after merger)	Cash	Calendar
Price Construction Company	Accrual	Fiscal, April 30

For its fiscal years ended November 30, 1952, and November 30, 1953, J. Gordon Turnbull, Inc., filed its income tax return with the district director in Cleveland, Ohio. J. Gordon Turnbull, Inc., filed a separate income tax return for the taxable year December 1, 1953, through February 4, 1954, with the district director, Cleveland, Ohio.

For its taxable year February 5, 1954, through December 31, 1954, and for each of its caledar years 1955, 1956, and 1957, J. Gordon Turnbull, Inc., filed a consolidated income tax return with its parent corporation, H. R. Henderson & Company. These consolidated returns were filed with the district director, Dallas, Texas.

Following the merger, the surviving corporation, Turnbull, Inc., filed its income tax return for its taxable year 1958 with the district director in Cleveland, Ohio.

For each of its 8 fiscal years ended April 30, 1951, through April 30, 1958, and for its taxable year May 1, 1958, through October 31, 1958, Price Construction Company filed its income tax returns with the district director, Dallas, Texas.

On December 15, 1953, the board of directors of H. R. Henderson & Company authorized its president, Cameron McElroy, Jr., to investigate the possibilities of purchasing J. Gordon Turnbull, Inc., and on January 18, 1954, he was authorized to purchase the stock of that company for any amount less than $1,150,000. In making this authorization one of the factors considered by the board was that a sizeable part of the purchase price could be obtained from the Turnbull organization.

On January 25, 1954, the 1624 shares of J. Gordon Turnbull, Inc., stock outstanding were owned by the Estate of J. Gordon Turnbull (1294 shares) and Susan A. Turnbull (330 shares). The corporation held 376 shares of treasury stock.

On January 25, 1954, B. C. McElroy and Cameron McElroy sumbitted to the Estate of J. Gordon Turnbull, deceased, and Susan A. Turnbull an offer to purchase all of the outstanding shares of J. Gordon Turnbull, Inc., for a sum of $975,000.

On January 27, 1954, Susan A. Turnbull accepted this offer individually and on behalf of the Estate of J. Gordon Turnbull by a telegram addressed to Cameron McElroy, Marshall, Texas.

Funds for the purchase of the outstanding shares of J. Gordon Turnbull, Inc., were provided:

By H. R. Henderson & Company:

Borrowed from Cameron McElroy and H. R. Henderson	$ 25,000.00
Borrowed from J. Gordon Turnbull, Inc.	801,108.37
Total	$826,108.37

By J. Gordon Turnbull, Inc., (treasury shares)	$148,891.63
Total	$975,000.00

On or about February 4, 1954, H. R. Henderson & Company acquired all of the outstanding shares of J. Gordon Turnbull, Inc., for a total price of $975,000 paid as follows:

Paid by H. R. Henderson & Company to:	No. of Shares	Amount
Susan A. Turnbull	330	$198,121.92
J. Gordon Turnbull Estate	1,046	627,986.45
Total amount paid by H. R. Henderson & Company		$826,108.37
Paid by J. Gordon Turnbull, Inc., to:		
Estate of J. Gordon Turnbull	248	$148,891.63
Totals	1,624	$975,000.00

As specified in the offer to purchase dated January 25, 1954, Susan A. Turnbull purchased from J. Gordon Turnbull, Inc., for cash the following assets at their book value as of December 31, 1954:

½ ton Chevrolet truck	$ 1,036.08
1952 Cadillac	3,537.03
Moraga Drive property	56,111.15
San Fernando ranch	118,280.50
Chester Avenue property	49,068.17
Ranch machinery and equipment	12,087.47
Total	$240,120.40

As of December 31, 1946, and through April 15, 1958, the outstanding stock of H. R. Henderson & Company had been issued as follows:

Name	Number of Shares	Percentage
H. R. Henderson	320	32
Cameron McElroy, Jr.	480	48
B. C. McElroy, Sr.	100	10
E. Key, III	100	10
Total	1,000	100

On December 18, 1953, the board of directors of Price Construction Company authorized Earnest F. Smith to investigate the accident claims pending against J. Gordon Turnbull, Inc., to determine if they could be defended with a reasonable amount of cost. From his knowledge of the circumstances of the accident McElroy believed the suits could be defended reasonably. After discussing the case with attorneys representing various defendants, Smith reported to the board on January 15, 1954, that he believed the cases could be disposed of with a reasonable amount of expense, and several board members were directed to negotiate for the purchase of the receivables.

After the death of J. Gordon Turnbull, which occurred on April 1, 1953, estimates were made of income accrued for services which had been rendered from the Kansas City office of J. Gordon Turbull, Inc., as of July 1, 1953. The corporation assigned the uncompleted contracts of job agreements in the Kansas City office to E. G. Novak, the manager of its Kansas City office, for completion. After April 1, 1953, J. Gordon Turnbull, Inc., accepted no new work until February 4, 1954.

By February 4, 1954, the uncollected balances due J. Gordon Turnbull, Inc., for services rendered on jobs up to that date, and the amount due on mortgages were estimated by J. Gordon Turnbull, Inc., to be as follows:

Job No.	Name of Job	Balance due J.G.T. Inc.	Description of Account Receivable: Due for Work Completed as of	Percent of Completion	Other Explanation
5213	Baptist Hospital, Kans. City	$ 23,549.15	7-8-53		
5120	Warrensburg Housing	5,722.25	7-1-53		
5114	U.S. Air Force	6,118.00	6-18-53	100%	Invoiced for $6,816.50
5121	U.S. Air Force	16,356.49	7-8-53	99	
5323	U.S. Air Force	247.90	7-1-53	57	10% retainage
5225	Beckett on Hallmark	19,646.22	7-1-53		
5314	Hallmark	2,046.90	7-1-53		
5313	Beckett for Hallmark	1,423.63	7-1-53		
5112	Kans. City Power & Light Co.	9,107.70	7-1-53	100	
5226	Kans. City Power & Light Co.	2,443.14	7-1-53	100	
5122	City of Warrensburg	7,634.58	7-1-53	100	
5105	General Motors Corp.	4,132.42	7-1-53	100	
4719	Veterans Hospital	118,989.28	7-8-53	100	Claimed $134,559.28; E. G. Novak expected to receive more than $118,989.28
5207	Lockheed Aircraft Corp.	42,489.00	7-8-53	various	
4808P	Brunsen Instrument Co.	—0—	1951		Cost on job $3,195.84; collection doubtful.
5211	U. S. Army-Reynolds Plant	37,052.21	6-10-53		Terminated for convenience of Govt.
5202	Reynolds Metals	65,726.25			
5304	U.S. Army-Reynolds Metals	5,500.00	6-10-53		Terminated for convenience of Govt.
5215	General Motors Corp.	9,831.18			
O. L. Beiswenger, note due 12-31-53		1,000.00			
Marine Corp. note secured By house & land at 11,239 Lake Shore Blvd., Bratenahl, Ohio; due in equal payments to be made on 11-1-54 and 11-1-55		20,000.00			
E. G. Novak (due for materials conveyed 7-1-53		21,510.68			
	Total	$420,526.98			

Acting under the authority of a resolution passed by its board of directors on February 4, 1954, J. Gordon Turnbull, Inc., executed an agreement to sell the above receivables and mortgages to Price Construction Company. Under terms of the assignment Price Construction Company was to pay $50,000 in cash and execute a 4 percent, 90-day promissory note for $150,000, or a total of $200,000, and to assume any liability determined against Turnbull as a result of suits filed against it as follows:

1. A claim for breach of contract damages filed by Jerry Clements in the U. S. District Court for the Western District of Arkansas, No. 551, in the amount of $3,950.

2. A claim for damage filed by co-partners, William G. Reed, C. H. Bacon, and John Priest with the Superior Court, Los Angeles, California, No. 611,219, in the amount of $38,250.

3. All claims against J. Gordon Turnbull, Inc., resulting from an accident at the Reynolds Metals Company, Gregory, Texas, plant on November 15, 1951, for which nine plaintiffs filed for the aggregate amount of $532,895.

The $50,000 in cash paid to J. Gordon Turnbull, Inc., on February 4, 1954, under the provisions of the agreement to sell the receivables, was advanced to Price Construction Company by H. R. Henderson and Cameron McElroy through two cashier's checks, each in the amount of $25,000.

The acquisition of the accounts receivable was entered on the Price Construction Company journal and posted to the ledger as follows:

	Debit	*Credit*
Accounts Receivable		
J. Gordon Turnbull, Inc.	$420,526.98	
Notes payable—		
J. Gordon Turnbull, Inc.		$150,000.00
H. R. Henderson and		
Cameron McElroy		50,000.00
Reserve for uncollectible accounts		
and liability on lawsuit corpus		220,526.98
To record acquisition of accounts receivable from J. Gordon Turnbull and acceptance of liability on lawsuit at Corpus.		

The same transaction was entered on the books of J. Gordon Turnbull, Inc., as follows:

	Debit	*Credit*
Accounts receivable miscellaneous—		
Price Construction Company	$ 50,000.00	
Notes receivable —		
Price Construction Company	150,000.00	
Accounts receivable—E. G. Novak		$ 20,273.80
Notes receivable—Marine Corp.		20,000.00
Notes receivable—O. L. Beiswenger		1,000.00
Fee income		158,726.20

On its income tax returns, J. Gordon Turnbull, Inc., reported as gain from the sale of receivables the following amounts:

Taxable Year Ended	*Amount*
2/4/54 (66/365 x $158,726.20)	$ 28,701.17
12/31/54 (299/365 x $158,726.20)	130,025.03
Total	$158,726.20

After February 4, 1054. J. Gordon Turnbull, Inc., received and entered on its books payments totaling $469,608.34 ($423,777.25 from February 4 through December 31, 1954,

and $45,831.09 during 1955) on these uncollected accounts as follows:

Total Payments Received During	*Amount*
February 1954	$ 85,976.37
March 1954	82,480.12
April 1954	49,202.68
May 1954	60,500.27
June 1954	115,449.45
July 1954	3,077.61
August 1954	24,400.00
December 1954	2,690.75
January 1955	2,500.00
February 1955	43,331.09
Total	$469,608.34

Upon collecting these amounts, J. Gordon Turnbull, Inc., immediately transmitted them to Price Construction Company.

Price Construction Company reported part of the proceeds from the collection of these accounts receivable as income in its fiscal year ended April 30, 1954, and the balance in its fiscal year ended April 30, 1955.

Price Construction Company made the following payments to J. Gordon Turnbull, Inc., in satisfaction of its $150,000 note:

Date of Payment	*Amount*
2-17-54	$ 50,000.00
4-5-54	25,000.00
4-28-54	25,000.00
5-26-54	5,000.00
6-7-54	15,000.00
6-24-54	15,000.00
7-2-54	10,000.00
8-4-54	5,000.00
Total	$150,000.00

As of February 4, 1954, J. Gordon Turnbull, Inc. had a basis of $41,273.80 in its accounts receivable. This amount was allowed as a basis deduction in the notice of deficiency issued for the year ended December 31, 1954, in Docket No. 1285-62.

As of April 17, 1952, and until August 26, 1952, the outstanding shares of Price Construction Company were owned as follows:

	Stock Ownership	
Stockholder	*Shares*	*Percent*
W. R. Price	299	49.83
Marvin Pound	1	.17
Cameron McElroy	299	49.83
B. C. McElroy	1	.17
Total	600	100.00

On August 26, 1952, Cameron McElroy acquired all the stock owned by W. R. Price in consideration for which Cameron McElroy transferred certain personal property to W. R. Price and assumed all obligations of Price Construction Company for which W. R. Price might be held liable.

At the stockholder's meeting of Price Construction Company on September 19, 1952, Cameron McElroy, who then owned at least 598 of the 600 shares outstanding, authorized the distribution of the 299 shares he had acquired from Price to various persons, but principally to H. R. Henderson, B. C. McElroy, and E. Key, Jr. After this distribution of Sep-

tember 19, 1952, the outstanding shares of Price Construction Company were owned as follows:

Stockholder	Stock Ownership	
	Shares	Percent
Cameron McElroy	299	49.83
H. R. Henderson	171	28.50
B. C. McElroy	58	9.67
E. Key, Jr., and/or his estate	57	9.50
O. H. Clark	11	1.82
Marvin Pound	1	.17
B. C. Burba	1	.17
W. L. Cravens, Jr.	1	.17
George Pendergast, Jr.	1	.17
Total	600	100.00

Prior to December 1, 1953, O. H. Clark, George Pendergast, Jr., W. L. Cravens, Jr., B. C. Burba, and Marvin Pound transferred their stock in Price Construction Company (a total of 15 shares) to Cameron McElroy. Then Cameron McElroy redistributed the outstanding shares as follows:

Stockholders	Shares Issued 9-19-52	Changes in Stockholding Shares Outstanding			
		Prior to 12-1-53		12-1-53	2-4-54
		Increase	(Decrease)	Number	Percent
Various—Clark, Pendergast, Cravens, Burba, Pound	15		(15)		
Cameron McElroy	299		(179)	120	20
H. R. Henderson	171		(3)	168	28
B. C. McElroy	58	2		60	10
E. Key, Jr., and/or his estate	57	3		60	10
John M. Henry		72		72	12
W. D. Henderson		60		60	10
Earnest F. Smith		60		60	10
Totals	600	197	(197)	600	100%

The shares outstanding on December 1, 1953, remained the same at least through February 4, 1954.

For each of the 3 fiscal years prior to its acquisition of accounts receivable from J. Gordon Turnbull, Inc., Price Construction Company's total liabilties exceeded its total assets, and it had reported operating losses on each of its income tax returns which losses were available to be carried forward and offset against future income. The excess of liabilities over assets and the net operating loss in each year were:

Particulars	*4-30-51*	*4-30-52*	*4-30-53*
Total Liabilities	$260,230.06	$121,172.68	$354,655.16
Total Assets	239,384.24	60,907.13	185,571.48
Excess of Liabilities over Assets	$ 20,945.82	60,265.55	$169,083.68
Net Operating Loss	$(100,450.20)	$(41,319.73)	$(108,818.13)

As recognized by the board of directors of H. R. Henderson & Company, it was well known that Cameron McElroy was closely associated with both Price Construction Company and H. R. Henderson & Company, and that the financial and business welfare of Price Construction Company was closely related to and had a substantial effect on the business of H. R. Henderson & Company, particularly Henderson's ability to secure further contracts. To avoid the problems which would have resulted from foreclosure on Price's assets or the bankruptcy of the company, the directors of H. R. Henderson & Company on April 10, 1952, agreed to pay Price Construction Company's debt to the First National Bank, Marshall, Texas, and thereafter continued to provide Price Construction with funds to carry on its opera-

tions in spite of its heavy losses. Henderson & Company also made efforts to secure profitable contracts for Price.

From the collections on the accounts receivable acquired from J. Gordon Turnbull, Inc., Price Construction Company was able during 1954 to return most of the funds furnished it by H. R. Henderson & Company.

During the years involved both Price Construction Company and H. R. Henderson & Company maintained their office in the same building on Pinecrest Drive West, Marshall, Texas. During 1955 Robert G. Maloney, an employee of H. R. Henderson & Company, also kept the books for Price Construction Company.

As of November 30, 1953, J. Gordon Turnbull, Inc., estimated its earned income from its accounts receivable, or the completed portion of jobs in process at $539,957.25. In estimating its 1954 income from these accounts, J. Gordon Turnbull, Inc., reduced the total income of $539,957.25 by a reserve totaling $26,997.86, which was shown as a valuation reserve on its accrual basis balance sheet at November 30, 1953. This amount of reserve was considered adequate to cover the larger amount of receivables, including the Veterans Hospital job Number 4719, which was included at $118,989.28, the same value at which it was assigned to Price Construction Company.

Prior to the assignment of the accounts receivable to Price Construction, each job was studied, the determined percentage of completion verified, an analysis made of previous payments, and the balance due as of February 4, 1954,

was conservatively calculated to be $420,526.98. Within 13 months following their assignment $469,608.34 was collected on these accounts.

J. Gordon Turnbull, Inc., estimated its 1954 income tax on work in process would be $219,436.36, which sum it showed as a reserve on its accrual basis balance sheet. It recognized that it would be liable for income tax on its accounts receivable from the completed portion of its jobs in process.

Under the terms of the agreement for the assignment of accounts receivable dated February 4, 1954, between J. Gordon Turnbull, Inc., and Price Construction Company, Price assumed any contingent liability Turnbull might have as a result of an accident which occured on November 15, 1951, during the construction of the Reynolds Metals Company plant at Gregory, Texas.

For the construction of its plant at Gregory, Reynolds Metals Company, the landowner, entered into six prime contracts, one with H. R. Henderson & Company and Henry C. Beck Company, who acted as general contractor as a joint venture, one with the petitioner, who was the architectural engineer, and four others. James Stewart Company was a subcontractor who built the storage silo in which the accident occurred.

On November 15, 1951, during the construction of an ore storage silo at the Reynolds plant, an accident occurred when a scaffolding or platform supported by reinforcing bars extending inside the silo collapsed. Twenty-two or 23 men who were on the scaffolding when it collapsed were injured, and

of these one, Vincent Charo, was killed. The injured men were all employed by James Stewart Company or another James Stewart Corporation.

James Stewart Company had drawn the plans for the actual construction of the silo in which the accident occurred. It also had control over the method of construction to be used in building the silo. The method of using a platform supported by reinforcing bars was decided upon and executed by James Stewart Company. It was not specified by J. Gordon Turnbull, Inc., and was not a part of its design.

As architectural engineer, Turnbull was responsible for drawing the plans for the finished product, the design of the entire plant, including specifications and working drawings, but they did not draw the construction plans for the actual building of the silo. Turnbull's duty of inspection on the premises was to determine that the finished product complied with their plans and specifications, as for example, ascertaining that the proper concrete mixture was being used. It was not its job to control in any way a subcontractor or his method of installation.

As a result of the accident at the Reynolds Metals plant eight tort suits were filed. Seven of these actions sought damages for personal injuries and one for alleged wrongful death (Mary Lamar Charo). In each case, by the original or amended petition, four defendants were named: H. R. Henderson & Company, Inc., Henry C. Beck Company, Reynolds Metals Company, and the petitioner. Each of these suits was filed by a person employed by James Stewart

Company at the time of the injury, or by such person's representative. Hubert L. Stone, Jr., was attorney for each of the plaintiffs, and the original petitions were filed on the following dates:

Petitioner	*Docket Number*	*Date Petition Filed*
Manuel Garcia, Sr.	8238	12-31-52
Lloyd G. Bazar	8371	5-15-53
Antonio Vasquez	8186	10-25-52
Antonio Canales	8376	5-15-53
Everett O. Rippee	8430	7-3-53
Mary Lamar Charo	8174	10-11-52
L. D. Bolter	8586	11-13-53
Ramon Maldonado	8519	9-12-53

Stone, as attorney for the plaintiffs, investigated the accident, including examining the contracts, the plans for the finished project, and the plans for construction of the silo, as well as talking to witnesses, and taking statements and depositions. Based on the information so obtained he determined what parties to name as defendants in the tort suits he filed. At the time the petitions were filed Stone believed he had the best chance for recovery against H. R. Henderson & Company, Henry C. Beck Company, and Reynolds Metals Company. At no time did he feel he had sufficient evidence to establish a prima facie case against Turnbull, but since it had duties on the premises where the accident occurred, it was necessary under Texas procedure to name J. Gordon Turnbull, Inc., as a codefendant in order to prevent the possible use of the sole proximate cause doctrine to bar any recovery.

~~In August 1953, Stone arranged to take the deposition of Fenister, the project manager for Beck and Henderson. The deposition was to be taken in Dallas, Texas. Eldon Dyer, attorney for J. Gordon Turnbull, Inc., believed at that time that Stone could not establish a prima facie case against it and felt that he could not justifiably charge it with the expense of his traveling from Corpus Christi to Dallas to attend the deposition. Stone told Dyer at that time that although he could not agree to a motion for summary judgment, he also believed he did not have a prima facie case against Turnbull.*~~

Based on his analysis of the cases, Stone disagreed with any prospect of liability on the part of Turnbull. Under the terms of the contract, the Beck-Henderson joint venture was required to indemnify Reynolds Metals Company against any loss from any cause of action arising from work done under the contract. In its contract with Beck-Henderson, James Stewart Company agreed to accept and assume all the liabilities, duties, and responsibilities created by the contract between Reynolds and Beck-Henderson. Since the contract of J. Gordon Turnbull, Inc., was directly with Reynolds, there was no privity of contract between the injured employees of James Stewart Company and petitioner. Furthermore, Reynolds retained control over the premises and there was no significant delegation of control to Turnbull.

* This paragraph was stricken by Order dated February 13, 1964 (R. 393).

~~Eldon Dyer discussed the privity of contract with Stone about 10 days prior to the Fenister deposition which was taken in August 1953.*~~

During November 1951, J. Gordon Turnbull, Inc., carried a comprehensive general liability policy with Bankers Indemnity Insurance Company, and a general liability policy with Employers Casualty Company. The insurance coverage under each policy was $50,000.

Employers Casualty Company was first notified of the accident by a letter dated January 13, 1953, from W. D. McArthur. Bankers Indemnity Company was similarly advised, as McArthur's letter was written to both companies. Bankers Indemnity Insurance Company disclaimed liability under its policy, but Employers Casualty Company undertook to investigate and defend the cases *after* receiving a non-waiver of rights agreement from Turnbull.

Falsgraf, Reidy, and Shoup, attorneys for Turnbull, believed that Bankers Indemnity Insurance Company was still liable under the provisions of the insurance policy and had no grounds for disclaiming liability. They advised Bankers that Turnbull did not waive any of its rights under its policy and would hold them responsible for all expenses and judgments obtained against it.

Employers Casualty Company completed its investigation of the accident on January 29, 1954. At that time, or shortly thereafter, based on the facts obtained from their investigation, Employers Casualty Company determined that there was no liability against J. Gordon Turnbull, Inc., on the

* This sentence was stricken by Order dated February 13, 1964 (R. 393).

lawsuits. Employers Casualty Company advised its reinsurer, Security Mutual Casualty Company, of the Reynolds plant accident and the facts developed by Employers' investigation thereof. With a knowledge of these facts, Security Mutual did not request Employers Casualty to take any special action with regard to the possible liability of J. Gordon Turnbull, Inc., and stated that it appeared doubtful that Turnbull was guilty of any negligence.

All of the cases filed against Turnbull were disposed of by a settlement which was finally arranged in October 1954, and judgments were entered on November 1, 1954. In settlement of the suits Employers Casualty Company paid $5,000 on behalf of Turnbull and obtained releases in all cases as a part thereof. Travelers Insurance Company paid $40,000 as insurer for Henry C. Beck Company and H. R. Henderson & Company, and James Stewart Company paid $4,350 in its own behalf. All the lawsuits were settled by the defendants for a total payment of $49,350. One reason the damage suits were settled for a total of $49,350 was all of the injured men, except Vincent Charo who was killed, had recovered, had returned to work, and were earning good money by the time the cases were settled. ~~Eldon Dyer knew of the recoveries by the injured men, some of whom returned to work within a few weeks after the accident.*~~

In its accrual basis balance sheet of November 30, 1953, Turnbull was careful to show many reserves for various expenses, including a $10,000 reserve for legal expenses on

* This sentence was stricken by Order dated February 13, 1964 (R. 393).

suits, but no reserve was established for any contingent liability on the lawsuits filed as a result of the Reynolds plant accident. The suits are not mentioned in a footnote to the balance sheet, although the petitions had all been filed prior to November 30, 1953.

The officers of Price Construction Company were of the opinion that the extent of contingent liability on the lawsuits would not exceed insurance coverage of $50,000, and no further indication of any contingent liability was made on the balance sheet of Price Construction Company as of February 28, 1954, which statement was examined by Q. B. Carlile, C.P.A., and as to which he rendered a qualified opinion.

At no time did either J. Gordon Turnbull, Inc., or Price Construction Company make any payment with regard to the lawsuits resulting from the Reynolds plant accident.

In the breach of contract suit filed by Jerry Clements against J. Gordon Turnbull, Inc., on May 7, 1953, the plaintiff claimed damages of $3,950. During 1953 the parties' attorneys negotiated a settlement of the case on the basis of $750, but Clements' attorneys were unable to contact him to obtain his approval. They requested, and on February 26, 1954, were permitted, to withdraw as counsel. On March 19, 1954, the case was dismissed for lack of prosecution.

On its income tax return for the year December 1, 1953, through November 30, 1954, J. Gordon Turnbull, Inc., reported a gain on sale of its accounts receivable in the amount of $158,726.20. In computing the tax due on this return,

J. Gordon Turnbull, Inc., prorated this gain, along with all its taxable income, between its separate return for the taxable period December 1, 1953, through February 4, 1954 (66 days), and the period February 5 through November 30, 1954 (299 days). For the latter period, the income of J. Gordon Turnbull, Inc., so prorated, was included in the consolidated return filed with and in the name of its parent company, H. R. Henderson & Company.

In the notice of deficiency pertaining to the consolidated return of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for the taxable year 1954 (Docket No. 1285-62), respondent determined that the income reported on said consolidated return should be increased by the amounts collected on the accounts receivable of J. Gordon Turnbull, Inc., during the period from February 4, 1954, through December 31, 1954, which collections amounted to $423,777.25. Respondent further determined that this sum could properly be reduced by a basis in said accounts of $41,273.80, collection expenses of $13,550.48 and the gain from sale of receivables reported by J. Gordon Turnbull, Inc., on its return for the period December 1, 1953, through November 30, 1954, in the amount of $158,726.20, leaving the determined increase in reported consolidated income for 1954 from this adjustment of $210,226.77. A similar determination was made in 1955, increasing reported consolidated income for 1955 by $45,831.09.

By adjustment (h) in the deficiency notice in Docket No. 1285-62, respondent makes no further adjustment increasing the consolidated income of H. R. Henderson & Com-

pany and J. Gordon Turnbull, Inc., for 1954, but rather makes the determination that certain items of income or deduction, as shown on the books of J. Gordon Turnbull, Inc., for its fiscal year ended November 30, 1954, including the $158,726.20 reported gain on sale of receivables, relate specifically to the period covered by the consolidated return filed with its parent company. The decrease in affiliated income resulting from such reallocation amounts to $5,211.83.

In the deficiency notice pertaining to the short taxable year of J. Gordon Turnbull, Inc., ended February 4, 1954 (Docket No. 88456), respondent determined that the $158,726.20 which J. Gordon Turnbull, Inc., reported as gain on sale of accounts receivable, should be completely reallocated to said short taxable year.

As a result of the issuance of notices dated May 13, 1960 (Docket No. 88456), and January 22, 1962 (Docket No. 1285-62), the sum of $158,726.20 was twice included in income since the sale of the accounts receivable was recognized by the Commissioner in his notice dated May 13, 1960 (Docket No. 88456), for the taxable year ended February 4, 1954, and the sale was not recognized by the Commissioner in his notice dated January 22, 1962 (Docket No. 1285-62), for the year ended December 31, 1954, but was considered by the Commissioner to have been income which was not reported on the consolidated return of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for the year 1954.

The $368,952.97 gain which respondent included in the deficiency notice to Turnbull, Inc., pertaining to taxable year ended December 31, 1954, was not removed from income

of Price Construction Company in the deficiency notice dated September 27, 1961 (Docket No. 95189), to that corporation, which notice respondent issued pertaining to its fiscal year ended April 30, 1958. The deficiency notice issued to Price Construction Company disallowed a net operating loss carryover with a determination that such carryover had been previously claimed as a deduction for the year ended April 30, 1955. In the examination of Price Construction Company's income tax return for the taxable years April 30, 1955, 1956, and 1957, respectively, the revenue agent rendered a no change report which was accepted by the Commissioner containing the following statement:

> "Since some of the gross income reported by this Corporation has been allocated to H. R. Henderson & Company and at informal conference held on that issue, taxpayer prefers not to execute an agreement to the no change shown above."

Had respondent removed the proceeds from the collection of said accounts receivable from Price Construction Company's income, when he determined them to be taxable to Turnbull, Inc., the operating loss deduction would have carried over to fiscal year ended April 30, 1958, of Price Construction Company.

Respondent determined that $5,753.26 claimed as a deduction for legal and professional expenses in the consolidated return of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for 1954 was not ordinary and necessary expense

and was not allowable as a deduction. The items comprising the sum disallowed are as follows:

2-26-54	Smith & Hall, Attorneys	Debt of Price Construction Co.	$2,253.26
3-4-54	Smith & Hall, Attorneys	Services rendered to J. Gordon Turnbull—trips to Dallas and Cleveland	1,650.00
4-6-54	C. J. Demmer & Company	Services rendered to Henderson in connection with acquisition of common stock of Turnbull	1,600.00
2-16-54	Peat, Marwick, Mitchell & Co.	Consultations conected with proposed acquisition of Turnbull billed to McElroy Construction Co.	250.00
		Total	$5,753.26

The $1,600 fee to C. J. Demmer & Company disallowed by respondent as not being an ordinary and necessary expense was paid to C. J. Demmer & Company for services rendered in connection with the acquisition of the common stock of J. Gordon Turnbull, Inc., and the purchase of accounts receivable of J. Gordon Turnbull, Inc., by Price Construction Company.

Smith & Hall, Attorneys, Marshall, Texas, were consulted with regard to H. R. Henderson & Company's acquisition of the common stock of J. Gordon Turnbull, Inc.

H. R. Henderson's acquisition of the common stock of J. Gordon Turnbull, Inc., and Price Construction Company's acquisition of the accounts receivable of J. Gordon Turnbull, Inc., were planned by the same persons and executed as part of the same transaction.

For each of the taxable years 1954 and 1955 H. R. Henderson & Company filed a consolidated income tax return with its subsidiary, J. Gordon Turnbull, Inc. Attached to each of these returns is Form 1122 in which J. Gordon Turnbull, Inc., consents to and agrees to be bound by the provisions of the consolidated return regulations. Each of these forms bears the seal of the subsidiary corporation, and the Form 1122 for 1955 is signed by its president.

In the notice of deficiency dated January 22, 1962 (Docket No. 1285-62), respondent determined that income tax deficiencies for the taxable years ended December 31, 1954, and December 31, 1955, were due from H. R. Henderson & Company (dissolved) and its affiliated company, J. Gordon Turnbull, Inc. Respondent further determined that Turnbull, Inc. (formerly J. Gorden Turnbull, Inc.), was transferee of the assets of H. R. Henderson & Company, and as such was liable for the amount of the deficiencies due, plus interest as provided by law.

Pursuant to the joint plan and agreement of merger between J. Gordon Turnbull, Inc., and H. R. Henderson & Company, entered into as of December 17, 1957, and effective December 31, 1957, H. R. Henderson & Company was merged with and into J. Gordon Turnbull, Inc., in a statutory merger pursuant to the provisions of the General Corporation Act of Ohio and the Texas Business Corporation Act of 1955, and the name of the surviving corporation, J. Gordon Turnbull, Inc., was changed to Turnbull, Inc.

By the terms of the merger the outstanding stock of H. R. Henderson & Company was surrendered in fixed proportions

in exchange for stock of Turnbull, Inc., the existence of H. R. Henderson & Company was terminated and it ceased to exist as of the effective merger date, December 31, 1957. The 1250 shares of J. Gordon Turnbull, Inc., stock then owned by H. R. Henderson & Company was similarly transferred to the surviving corporation. The common stock of the surviving corporation which would have been distributable to H. R. Henderson & Company in return for the 1250 shares of J. Gordon Turnbull, Inc., which Henderson Company held at the time of the merger, was distributed instead directly to the former shareholders of H. R. Henderson & Company in proportion to their former holdings of its stock.

Under the merger, Turnbull, Inc., assumed all debts, liabilities, and duties of H. R. Henderson & Company with the further provision that they attached to the surviving corporation and could be enforced against it to the same extent as if such debts, liabilities, and duties had been incurred or contracted by it.

Robert G. Maloney, secretary of petitioner Turnbull, Inc., executed a transferee agreement, Form 2045, admitting that Turnbull, Inc., is the transferee of the assets of H. R. Henderson & Company and assuming and agreeing to pay all Federal taxes finally determined or adjusted as due from H. R. Henderson & Company for the taxable years 1954, 1955, and 1956, to the extent of its liability at law or in equity, as transferee within the meaning of section 6901 of the Internal Revenue Code of 1954.

For its fiscal year ended April 30, 1955, Price Construction Company reported on its return the sum of $244,118.41 as income described therein as "Excess of Receipts over Purchase Price of Accounts Receivable."

On its income tax returns for each of its fiscal years ended April 30, 1951, through April 30, 1958, and for its taxable year May 1 through October 31, 1958, Price Construction Company reported net income or losses, without regard to net operating loss deductions, as follows:

Fiscal Year Ended	*Reported Net Income or (Loss)*
April 30, 1951	$(100,450.20)
April 30, 1952	(41,319.73)
April 30, 1953	(108,818.13)
April 30, 1954	(12,138.62)
April 30, 1955	169,002.20
April 30, 1956	(19,819.80)
April 30, 1957	20,738.81
April 30, 1958	76,184.19
October 31, 1958	(4,906.92)

In computing its taxable income for its fiscal year ended April 30, 1955, Price Construction Company took a net operating loss deduction in the amount of $169,002.20 for net operating loss carryovers claimed from each of its fiscal years ended April 30, 1951, April 30, 1952, April 30, 1953, and April 30, 1954.

In computing its taxable income for its fiscal year ended April 30, 1958, Price Construction Company took a net operating loss deduction in the amount of $76,184.19 for the net operating loss carryover from its fiscal year ended April 30, 1953.

In the notice of deficiency issued to Price Construction Company for its fiscal year ended April 30, 1958, respondent determined that the net operating loss of $76,184.19 claimed on the return for that year was unallowable since Price had previously claimed the same amount as a deduction from its income for the year ended April 30, 1955.

OPINION.

Issue 1.

Turnbull, Inc., denies its liability for the asserted deficiencies as a transferee because the notice of transferee liability does not place the primary tax liability of J. Gordon Turnbull, Inc., in issue and is therefore void. Alternatively, Turnbull, Inc., contends its liability as a transferee has not been proved by the respondent.

It is respondent's position that Turnbull, Inc., is liable as transferee for deficiencies determined as due for 1954 and 1955 from H. R. Henderson & Company, transferor. H. R. Henderson & Company is thus primarily liable for the determined deficiencies and its liability was assumed by Turnbull, Inc., under the terms of the statutory merger agreement, in which all of Henderson's assets were transferred to the surviving corporation and Henderson was dissolved. Based on this contractual assumption of liability, respondent contends that Turnbull, Inc., is liable for the determined deficiencies as a transferee at law, and as such the respondent need not prove that the net value of assets transferred exceeded the asserted deficiencies.

We agree with the respondent's position.

For each of the calendar years 1954 and 1955, H. R. Henderson & Company filed a consolidated income tax return with its subsidiary, J. Gordon Turnbull, Inc. The income of J. Gordon Turnbull, Inc., from February 5 through December 31, 1954, is includable in the consolidated return for 1954. In the notice of deficiency dated January 22, 1962 (Docket No. 1285-62), respondent determined that deficiencies in income tax for the taxable years ended December 31, 1954, and December 31, 1955, were due from H. R. Henderson & Company (dissolved) and its affiliated company, J. Gordon Turnbull, Inc.

Under the appplicable provisions of the Internal Revenue Code of 1954 the privilege of making a consolidated return is based on the condition that all the corporations which comprise the affiliated group (H. R. Henderson & Company and J. Gordon Turnbull, Inc,, in this case) consent to all the consolidated return regulations prescribed under section 1502. The regulations under section 1502 apply to the years now before the Court. See sections 1.1502-0 and 1.1502-1(b), Income Tax Regs.

In accordance with section 1.1502-12(b) of the regulations, J. Gordon Turnbull, Inc., executed and attached to each of the consolidated returns for 1954 and 1955 a Form 1122, consenting to the regulations under section 1502 and authorizing H. R. Henderson & Company to make a return on its behalf. The notice of deficiency in the instant case was

properly mailed to the transferee of Henderson, the parent company, as provided in the regulations. See section 1.1502-16(a), Income Tax Regs.

The regulations further provide that the common parent and each subsidiary member of an affiliated group during any part of a consolidated return period is severally liable for the tax for the consolidated period, including any deficiency with respect thereto. Section 1.1502-15(a). The tax liability for each corporation for each consolidated period is to be computed, in general, on consolidated taxable income of the affiliated corporations. Section 1.1502-30. Thus, H. R. Henderson & Company, the parent corporation in whose name the consolidated returns for 1954 and 1955 were filed, was liable for the entire amount of tax due as shown on each return and is liable for any deficiency determined and adjudged applicable to each year as a result of an increase in consolidated taxable income. Under the applicable regulations the affiliated corporation is similarly liable for any tax and deficiency based on the entire amount of consolidated taxable income in each year. It therefore follows that both H. R. Henderson & Company and J. Gordon Turnbull, Inc., are primarily liable for any deficiency in income tax due for either of the years 1954 and 1955, based on the entire amount of consolidated taxable income as adjusted.

Turnbull, Inc., admits that it is the transferee of the assets of H. R. Henderson & Company, and further admits that it has assumed and agreed to pay all Federal income taxes finally determined or adjudged as due from H. R. Henderson & Company for the taxable years 1954 and 1955, "to the extent of its liability at law or in equity, as a transferee with-

in the meaning of section 6901 of the Internal Revenue Code of 1954." Respondent claims that the extent of Turnbull, Inc.'s liability as a transferee is governed by the terms of the merger agreement between J. Gordon Turnbull, Inc., and H. R. Henderson & Company, and that under the terms of this merger Turnbull, Inc., is liable at law for the full amount of the deficiencies determined herein.

Pursuant to the joint plan and agreement of merger between J. Gordon Turnbull, Inc., and H. R. Henderson & Company, entered into as of December 17, 1957, and effective December 31, 1957, H. R. Henderson & Company was merged with and into J. Gordon Turnbull, Inc., in a statutory merger pursuant to the provisions of the General Corporation Act of Ohio and the Texas Business Corporation Act of 1955, and the name of the surviving corporation, J. Gordon Turnbull, Inc., was changed to Turnbull, Inc. By the terms of the merger, the outstanding stock of H. R. Henderson & Company was surrendered in fixed proportions in exchange for stock of Turnbull, Inc., the existence of H. R. Henderson & Company was terminated and it ceased to exist as of the effective merger date, December 31, 1957. The 1250 shares of J. Gordon Turnbull, Inc., stock then owned by H. R. Henderson & Company were similarly transferred to the surviving corporation. The common stock of the surviving corporation which would have been distributable to H. R. Henderson & Company in return for the 1250 shares of J. Gordon Turnbull, Inc., which Henderson Company held at the time of the merger, was distributed instead directly to the former shareholders of H. R. Henderson & Company in proportion to their former holdings of its stock. As a result of the merger

and distribution to Turnbull, Inc., of all of the assets of H. R. Henderson & Company, Henderson was left without assets or property of any value and its existence ceased on December 31, 1957. Under the merger, Turnbull, Inc., "assumed all debts, liabilities and duties" of H. R. Henderson & Company with the further provision that they attached to the surviving corporation and could be enforced against it to the same extent as if such debts, liabilities, and duties had been incurred or contracted by it. Included in the debts assumed in the merger by Turnbull, Inc., was any additional tax liability of H. R. Henderson & Company for 1954 and 1955, for on the effective date of the merger all the events had occurred which fixed the amount of the tax and determined H. R. Henderson & Company's liability with regard thereto. *Continental Baking Co.*, 27 B.T.A. 884 (1933), affd. 75 F. 2d 243 (C.C.A. D.C. 1934), certiorari denied 295 U.S. 756 (1935)

Where a transferee receives all of the assets of a transferor, after which the transferor is dissolved, and there is a contractual agreement by the transferee to assume the debts and pay the liabilities of the transferor, the transferee is liable, as matter of law, for income tax liability of the transferor for periods prior to the transfer. In asserting transferee liability at law, as distinguished from liability in equity, respondent need not prove the value of assets transferred but is entitled to rely on the transferee's contractual liability. See *American Equitable Assurance Co. of New York*, 27 B.T.A. 247 (1932), affd. 68 F. 2d 46 (C.C.A. 2, 1933); and *Kamen Soap Products Co., Inc., v. Commissioner*, 230 F. 2d 565 (C.A. 2, 1956). Cases cited by petitioner—*Estate of*

Joseph Nitto, 13 T.C. 858 (1949); *Ludwig Vogelstein*, 16 B.T.A. 947 (1929); and *Elaine Yagoda*, 39 T.C. 170 (1962) —are distinguishable since they each involve an attempted assertion of transferee liability in equity rather than at law. In none of the cited cases did the alleged transferee contractually assume the existing liabilities of the transferor.

In cases involving statutory mergers where the surviving corporation assumed the liabilities of the merged corporation, it has been held that the survivor was liable as transferee for the tax liability of the merged corporation. See *Texsun Supply Corporation*, 17 T.C. 433 (1951); and *Kaufmann Department Stores Securities Corporation*, 2 T.C. 656 (1943), affd. 144 F. 2d 776 (C.C.A. 3rd 1944), which involved a merger almost identical to that in the instant case.

Issue 2.

As we view it, whether the collections realized during 1954 and 1955 on the accounts receivable are taxable to J. Gordon Turnbull, Inc., or to Price Construction Company depends entirely on whether the sale to Price was an arm's length transaction for valuable consideration. The petitioners argue that it was. Respondent disagrees and submits that the sale was without substance and invalid for tax purposes. The resolution of this question must be determined from all the facts and circumstances involved.

Both parties agree that accounts receivable may be assigned in an arm's length transaction for valuable consideration, and that under such circumstances the assignor is subject to tax on the purchase price received and the assignee is taxable only to the extent that the collections he

receives exceed his basis. *Lewis N. Cotlow*, 22 T.C. 1019 (1954), affd. 228 F. 2d 186 (C.A. 2, 1955). But respondent's position is that in the instant case the necessary prerequisites to this general principle are lacking. Viewing the evidence in its entirety on this factual issue, we are persuaded that the assignment of the accounts receivable was not a valid arm's length transaction for valuable consideration. While our Findings of Fact are complete in this respect, there are a few points that warrant our comments.

An arm's length transaction generally means one between parties with adverse economic interests. To determine whether a sale between two corporations is at arm's length, it is necessary to look at the stockholders behind the corporate structure. *Campana Corporation v. Harrison*, 114 F. 2d 400 (C.C.A. 7, 1940). Here the economic interest of H. R. Henderson & Company and Price Construction Company were the same since they were controlled by the same stockholders, H. R. Henderson, Cameron McElroy, Jr., and B. C. McElroy, Sr. From 1946 to April 15, 1958, these three men owned 90 percent of the outstanding stock of H. R. Henderson & Company and 58 percent of the stock of Price Construction Company on February 4, 1954, the date of the assignment. ~~Moreover, there was no adverse economic interest between J. Gordon Turnbull, Inc., and Price Construction Company on February 4, 1954, since Turnbull was then controlled by H. R. Henderson & Company.*~~ ***Thus, in substance, there was no adversity between J. Gordon Turnbull, Inc., and Price Construction Company.***

* This sentence was stricken and replaced by the sentence next following by Order dated February 13, 1964 (R. 393).

We think the principal purpose of the assignment of Turnbull's accounts receivable to Price was to avoid the income tax that would be due upon their collection. Price had reported net operating losses of $100,450.20, $41,319.73, and $108,818.13 for each of its 3 fiscal years ended April 30, 1951, 1952, and 1953, respectively, and these losses were available to be carried forward and offset against the amounts to be collected on the Turnbull receivables. Since Price would be able to realize this income tax free, Henderson Company could then recover from Price the funds it had previously advanced to enable Price to carry on its operations. It thus seems clear to us that the sole purpose of the transfer of the accounts to Price, rather than their being acquired by Henderson, was to avoid tax liability, and that Henderson's acquisition of the Turnbull stock and the transfer of the accounts to Price were planned and executed as part of the same transaction.

After the death of J. Gordon Turnbull, his corporation ceased to engage actively in business until after February 4, 1954. On November 30, 1953, J. Gordon Turnbull, Inc., was in excellent financial condition and had cash of $521,713.77, current assets substantially in excess of all liabilities and revenues, and a large amount of accumulated capital and surplus ($1,006,443.50 on an accrual basis; $805,297.10 on a cash basis). By February 4, 1954, the corporation was in an even more liquid position as it sold most of its fixed assets at their book value as of December 31, 1954, to Susan A. Turnbull for a total cash price of $240,120.40. The board of directors of Turnbull recognized that the cash position

of the corporation on February 4, 1954, was such that it could loan a substantial sum to H. R. Henderson & Company. In the light of Turnbull's exceptionally good cash and financial condition and its restricted operations from April 1, 1953, through February 4, 1954, there was no valid business purpose for its selling approximately $420,000 of accounts receivable, as to which there was little doubt of collectibility, for $50,000 cash, the assumption of virtually non-existent contingent liability, and a $150,000 90-day note, the payments on which would be based on the amounts actually collected on the receivables themselves. Turnbull merely had to collect these accounts, and it could afford to do so since its cash on hand vastly exceeded the requirements of its then inactive business.

As of February 4, 1954, there was little doubt as to the collectibility of the accounts receivable assigned, and that they were worth approximately $420,526.98, the total uncollected balances due thereon. Each of these accounts, or jobs, had previously been carefully studied and analyzed, the determined percentage of completion on each job verified, an analysis made of previous payments, and the balances due at February 4, 1954, conservatively calculated to be $420,526.98.

Two major facts support respondent's contention that the receivables were worth about $420,000 on February 4, 1954. First, immediately following the assignment large sums were received within a short period. The actual collections on these accounts totaled $469,608.34. By the end of June 1954, a little less than 5 months after the assignment, $393,608.89

had been collected on the assigned accounts; by December 31, $423,777.25 had been received; and an additional $45,831.09 was collected in January and February 1955. From the large amount and rapidity of these collections, the full value and collectibility of these accounts is clearly confirmed. The officers of Turnbull must have had complete knowledge that these amounts were worth at least $420,000, and that such sum could be quickly and easily collected if and when they desired to do so.

Second, that the officers of Turnbull were cognizant of the actual value of the receivables is shown by the fact that in estimating its 1954 income from these accounts, total estimated income of $539,957.25 was reduced by a valuation reserve aggregating only $26,997.86. These accounts were shown on the accrual basis balance sheet of J. Gordon Turnbull, Inc., as of November 30, 1953. The important point is that a valuation reserve of $26,997.86 was considered adequate to cover not only those accounts assigned to Price on February 4, 1954, but also other receivables totaling a much larger amount of receivables than those assigned to Price.

As Turnbull made the collections on the assigned accounts, it immediately sent the proceeds to Price Construction Company. From these collections Price paid its $150,000 note to Turnbull and was able during 1954 to return most of the funds previously furnished it by H. R. Henderson & Company. In effect, Price merely served as a conduit for Henderson to withdraw earnings and funds from Turnbull tax free.

These accounts were assigned to Price Construction Company for $50,000 in cash, plus a 90-day note for $150,000 and the assumption of any liability Turnbull might have as a result of certain lawsuits filed against it, principally those resulting from an accident at the Reynolds Metals Company plant in Gregory, Texas. We agree with respondent's contention that the recited assumption of these contingent liabilities was meaningless and of no value as consideration because, as the parties knew when they drafted the assignment, any possibility of such contingent liability was so remote as to be virtually non-existent. See our discussion of this matter in the related case of *J. Gordon Turnbull, Inc.*, 41 T.C. No. 39 (December 12, 1963). Thus, we regard the consideration received by J. Gordon Turnbull, Inc., for the assignment of the accounts receivable as wholly inadequate.

In essence, what happened here is that Turnbull transferred receivables having a value of approximately $420,000 for a consideration of only $200,000. Under these circumstances we are unwilling to allow Turnbull to shift the tax due on income which it had clearly earned and was merely waiting to collect. See *J. Ungar, Inc.*, 26 T.C. 331 (1956), affd. 244 F. 2d 90 (C.A. 2, 1957); *Wood Harmon Corporation v. United States*, 311 F. 2d 918 (C.A. 2, 1963). Cases cited by the petitioners, such as *Jones v. Commissioner*, 306 F. 2d 292 (C.A. 5, 1962), and *Wellhouse v. Tomlinson*, 197 F. Supp. 739 (S.D. Fla., 1961), are distinguishable on their facts.

Accordingly, we hold that the collections during 1954 and 1955 on the accounts receivable assigned to Price Construc-

tion Company are taxable to J. Gordon Turnbull, Inc., and includable in the consolidated taxable income of H. R. Henderson & Company and affiliate for each of those years. In so holding it becomes unnecessary for us to consider respondent's alternative argument as to the applicability of section 482, Internal Revenue Code of 1954.

Issue No. 3.

Petitioner's contention that it is entitled to an additional decrease in affiliated income of $158,726.20 appears to be incorrect. In the notice of deficiency pertaining to the consolidated return of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for the taxable year 1954 (Docket No. 1285-62), respondent determined that the income reported on the consolidated return should be increased by the amounts collected on the accounts receivable of J. Gordon Turnbull, Inc., during the period from February 4, 1954, through December 31, 1954, which collections amounted to $423,777.25. Respondent further determined that this sum could properly be reduced by a basis in said accounts of $41,273.80, collection expenses of $13,550.48, and the gain from sale of receivables reported by J. Gordon Turnbull, Inc., on its return for the period December 1, 1953, through November 30, 1954, in the amount of $158,726.20, leaving the determined increase in reported consolidated income for 1954 from this adjustment of $210,226.77.

By adjustment (h) in the deficiency notice in Docket No. 1285-62, respondent makes no further adjustment increasing the consolidated income of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for 1954, but rather makes the

determination that certain items of income or deduction, as shown on the books of J. Gordon Turnbull, Inc., for its fiscal year ended November 30, 1954, including the $158,726.20 reported gain on sale of receivables, relate specifically to the period covered by the consolidated return filed with its parent company. By this adjustment respondent is treating the petitioner as if the transfer of receivables had never occurred; that is, adjustment (h) computes what Turnbull's portion of consolidated taxable income would have been if it had reported the entire gain on sale receivables ($158,726.20) in the consolidated period February 5 through December 31, 1954, rather than only 299/365 of the gain. Then, in adjustment (f), the entire amount of reported gain ($158,726.20) is allowed as a deduction, not just 299/365 of such gain, as was originally reported in the consolidated period. As we see it, the net effect of adjustments (f) and (h) is to disregard the assignment of the accounts receivable and to increase consolidated taxable income by $210,226.77, thus allowing petitioner credit for the full amount of income ($158,726.20) reported on the return for its fiscal year ended November 30, 1954, but which Turnbull had allocated 66/365 to the short period ended February 4, and 299/365 to the long period ended December 31, 1954.

Issue No. 4.

Respondent determined that $5,753.26 claimed as a deduction for legal and professional expenses in the consolidated return of H. R. Henderson & Company and J. Gordon Turnbull, Inc., for 1954 was not ordinary and necessary expense and was not allowable as a deduction. These items

are set forth in our Findings of Fact. The petitioner Turnbull, Inc., does not discuss the disallowance of these claimed deducutions in either its original or reply. Consequently, it would appear that this issue has been abandoned by the petitioner. But, in any event, the issue is factual and the and the evidence on the point indicates that the $1,600 fee of C. J. Demmer & Company disallowed by respondent as not being an ordinary and necessary expense was paid to C. J. Demmer & Company for services rendered in connection with the acquisition of the common stock of J. Gordon Turnbull, Inc., and the purchase of accounts receivable of J. Gordon Turnbull, Inc., by Price Construction Company. The statement rendered to H. R. Henderson & Company by C. J. Demmer & Company shows that Smith & Hall, Attorneys, Marshall, Texas, were consulted with regard to H. R. Henderson & Company's acquisition of the common stock of J. Gordon Turnbull, Inc.

The rule that legal and professional fees paid in connection with the acquisition of capital stock are nondeductible capital expenditures is clearly established. *Atzingen-Whitehouse Dairy, Inc.*, 36 T.C. 173 (1961). Similarly, legal fees paid on behalf of, and for services rendered to, another are not deductible as ordinary and necessary expenses of the payor. *Royal Cotton Mill Co.*, 29 T.C. 761 (1958); and *J. Gordon Turnbull, Inc., supra.*

Issue No. 5.

Having determined that J. Gordon Turnbull, Inc., rather than Price Construction Company, is subject to tax on the collections from the accounts receivable assigned by Turn-

bull to Price, it follows, as we have found, that the respondent erroneously disallowed Price Construction Company the net operating loss deduction in its taxable year ended April 30, 1958, as a result of a net operating loss carry forward from its fiscal year ended April 30, 1953.

Decisions will be entered under Rule 50.

TURNBULL, INC., TRANSFEREE (Formerly J. Gordon Turnbull, Inc.),

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 1285-62
Filed June 16, 1964

JGT and HRH corporations entered into a joint plan and agreement of merger pursuant to State law, and the name of the surviving corporation was changed to Turnbull, Inc., the petitioner. HRH corporation was left without assets and its existence ceased on December 31, 1957. The merger agreement provided that all debts, liabilities, and duties of the constituent corporations attached to the surviving corporation and could be enforced against it as if incurred or contracted by it. Later petitioner executed a transferee agreement admitting that it was a transferee of the assets of HRH corporation and agreed to assume and pay all Federal taxes determined to be due from HRH for the year 1954 through 1956 to the extent of its liability at law or in equity as a transferee under section 6901, I.R.C. 1954. *Held:*

1. Respondent is not required to plead specifically whether transferee liability is asserted at law or in equity.

2. Notice of petitioner's liability as transferee asserted primary liability against HRH for the determined deficiencies.

3. After the merger the assets of HRH were vested in petitioner. Notwithstanding State law, there was a transfer of assets to petitioner in view of the specific terms of the transferee agreement. *Commissioner v. Oswego Falls Corporation*, 71 F. 2d 673, distinguished, and *Texsun Supply Corporation*, 17 T.C. 433, followed.

4. Insolvency of transferor is not necessary to establish transferee liability at law.

5. Transferee agreement is valid and binding on petitioner. There was no lack of mutuality because respondent's forebearance in issuing a deficiency notice to HRH was sufficient consideration to support petitioner's promises to assume and pay deficiencies of HRH.

Wentworth T. Durant and *Leslie C. Hackler, Jr.*, for the petitioner. *Charles B. Sklar*, for the respondent.

SUPPLEMENTAL OPINION

DAWSON, *Judge:* On December 24, 1963, we filed our Memorandum Findings of Fact and Opinion (T.C. Memo, 1963-335) in this proceeding. Our findings of fact and opinion were later amended in certain respects by our order of February 13, 1964.

On April 2, 1964, the petitioner filed its Motion to Vacate the Trial Court's Opinion and on April 13, 1964, filed its Motion to Amend Petitioner's Motion to Vacate the Trial Court's Opinion. Points and authorities were submitted in support of petitioner's position that the Court erred in holding H. R. Henderson & Co. primarily liable for deficiencies in income tax for the taxable years 1954 and 1955, and that the petitioner, Turnbull, Inc., was liable as a transferee at law for the deficiencies determined against H. R. Henderson & Co.

On April 29, 1964, the Court heard extensive oral arguments on the motions by counsel for both parties and took the matter under advisement.

After carefully considering the various points raised in petitioner's motions, and respondent's memorandum in opposition thereto, we have decided to set out our views in this supplemental opinion.

First, we have concluded that there is no merit to petitioner's argument that the respondent failed to mention *transferee liability at law* in his statutory notice of deficiency or failed to plead it affirmatively in his answer. The notice of petitioner's liability as transferee, dated January 22, 1962, provides, in part, as follows:

> The above-stated amounts represent your liability as transferee of assets of H. R. Henderson & Co., (Dissolved) and affiliate, for the deficiencies in income tax due from that corporation for the taxable years ended December 31, 1954, and December 31, 1955, plus interest as provided by law.
>
> The records of this office indicate that you are the surviving company of a merger agreement with H. R. Henderson & Co.
>
> You have filed with this office an agreement that you are liable as transferee of the assets of H. R. Henderson & Co., and the above amounts represent your liability as transferee of the assets of H. R. Henderson & Co., Pinecrest Drive West, Marshall, Texas.

The affirmative allegations in respondent's answer are sufficient to sustain, along with the evidence adduced, a finding of transferee liability. In paragraph 7 the respondent pleaded the merger agreement, the transfer of assets to petitioner

leaving H. R. Henderson & Co. without assets of any value, and the termination of the separate corporate existence of Henderson as a result of the merger. Respondent need not specifically state, as petitioner contends, whether transferee liability is asserted *at law* or *in equity*. *Francis E. Drake*, 30 B.T.A. 475 (1934).

Likewise, the petitioner's statement that the notice failed to assert any *primary* liability is incorrect. Although the notice was issued to Turnbull, Inc., as transferee, it states that H. R. Henderson & Co. is primarily liable for the determined deficiencies. The first sentence thereof reads:

> It is determined that there is due from H. R. Henderson & Co., (Dissolved) and affiliated company, income tax deficiencies for the taxable years ended December 31, 1954, and December 31, 1955, in the aggregate amount of $157,902.49, as shown in the attached statement.

This contention is not new. A similar argument was advanced in petitioner's original brief (pp. 11-12) and in its reply brief (pp. 4-7). In fact, in its original brief (p. 12) petitioner admitted to the extent H. R. Henderson & Co. was primarily liable, the notice asserting transferee liability against Turnbull, Inc., was proper. However, petitioner's present approach is somewhat different. Previously it was contended that J. Gordon Turnbull, Inc., which survived the merger as Turnbull, Inc., was primarily liable because the income in question had been realized by the consolidated group from collections on accounts receivable due J. Gordon Turnbull, Inc. Now petitioner argues that the surviving corporation, Turnbull, Inc., is primarily liable, and in no way

secondarily liable, because the statutory merger laws of Texas and Ohio provide that the creditors of the merger corporation *may* prosecute their claims against either the merged corporation or the surviving corporation. See Tex. Bus. Corp. Act Ann. art. 5.06 and Ohio General Corporation Law, Ohio Rev. Code Ann., sec. 1701-83.

Was there a transfer of assets from H. R. Henderson & Co. to the petitioner? We think there was. This is established by two documents in the record. Article XI of the merger agreement provides that all property of each constituent corporation shall vest in the surviving corporation, and that—

> The corporate entity and separate existence of H. R. HENDERSON AND COMPANY, except insofar as the same may be continued by Statute, shall cause, and it shall be merged into the Surviving Corporation, in accordance with the provisions of this Joint Plan and Agreement of Merger.

Also, the transferee agreement (Form 2045) provides:

> In consideration of the Commissioner of Internal Revenue not issuing a statutory notice of deficiency to and making an assessment against the above-named transferor corporation [H. R. Henderson & Co.], the undersign [Turnbull, Inc.] admits that it is the transferee of assets received from said transferor corporation, and assumes and agrees to pay the amount of any and all Federal income, excess-profits, or profits taxes finally determined or adjudicated as due and payable to the above-named transferor corporation for the taxable year (or years) ended 1954, 1955 and 1956, to the extent of its liability at law or in equity, as a trans-

feree within the meaning of Section 6901 of the Internal Revenue Code of 1954 and corresponding provisions of prior internal revenue laws.

Logically there had to have been a transfer. Before the merger H. R. Henderson & Co. owned assets. After the merger these assets were vested in petitioner, the surviving corporation, and Henderson's separate existence ceased. Even if, as petitioner now claims, Henderson retained some type of interest in the assets, the petitioner after the merger had acquired an interest in those assets that it had not enjoyed prior to the merger. In our opinion the vesting of such interest constitutes a transfer, notwithstanding State law, where, as here, it was agreed that there was a transfer of assets to petitioner.

It is obvious that a statutory merger places respondent in a rather difficult position with regard to the issuance of a proper deficiency notice. If he issues the notice to the transferor asserting direct and primary liability, he meets the objection that the corporation is no longer in existence. If a notice is issued to a merged transferor in reliance upon the provisions of statutory merger statutes of the various States, as petitioner now asserts would have been the proper procedure in this case, then respondent is forced to rely on the particular provisions of the law in each State, as well as such peculiar procedural problems as might arise under such law. The risks of misinterpreting the provisions of each State's law and procedure are indeed great, and where the laws of two or more States are involved, as here, problems might arise to invalidate the deficiency notice. On

the other hand, if respondent issues a transferee notice, he may face the argument now made by petitioner. To solve his dilemma in this case, the respondent obtained an agreement from petitioner that if respondent would refrain from issuing a notice to H. R. Henderson & Co., petitioner would admit it was a transferee of assets of Henderson and assumed and agreed to pay the tax due from Henderson, as a transferee under the provisions of section 6901, I.R.C. 1954. In reliance on this agreement respondent did not issue a deficiency notice to H. R. Henderson & Co.—a notice which could have been issued to Henderson when petitioner agreed that it was a transferee since the statute was still open under consents at that time. If respondent had issued a deficiency notice to Henderson, the factual pattern would have been similar to that present in *Popular Library, Inc.*, 39 T.C. 1092 (1963), and petitioner could have been held primarily liable. Instead, in reliance on the transferee agreement, respondent properly issued a notice of transferee liability to petitioner. We believe petitioner cannot now assert, in good faith, that it is not a transferee, that it is primarily and not secondarily liable, and that there was no transfer of property incident to the merger. To permit this under these circumstances would be to allow petitioner to ignore and avoid its transferee liability as well as abrogate the basic intent and purpose of the State merger statutes, viz, to protect the creditors of the merged corporation and to assist them in collecting their claims.

We are persuaded that the weight of judicial authority supports our finding of transferee liability at law in the

instant case. See *West Texas Refining & Development Co. v. Commissioner*, 68 F. 2d 77 (C.A. 10, 1933); *Texsun Supply Corporation*, 17 T.C. 433 (1951); *Kaufmann Department Stores Securities Corporation*, 2 T.C. 656 (1943), aff'd. 144 F. 2d 776 (C.A. 3, 1944); and *Gideon-Anderson Co.*, 20 B.T.A. 106 (1930).

The many cases cited by petitioner are distinguishable. *Bowman Hotel Corporation*, 25 B.T.A. 1193 (1931), *Skaneateles Paper Co.*, 29 B.T.A. 150 (1933), involved situations where a deficiency notice was issued to a consolidated corporation, and the consolidating corporation filed a petition. New York law had separate and different provisions regarding consolidations and mergers. The cases merely hold that under the New York law tax liability could not be asserted against a consolidated corporation. They do not involve any question of, or any attempt to assert, transferee liability. *Commissioner v. Oswego Falls Corporation*, 71 F. 2d 673 (C.A. 2, 1934), is distinguishable, as discussed in the *Texsun Supply Corporation* case, on the ground that there was no definite contractural obligation to pay the taxes of the consolidating corporation involved and no transferee consent (Form 977). *Alaska Salmon Co.*, 39 B.T.A. 455 (1939), held that a surviving corporation may file a petition in response to a deficiency notice issued to a merged corporation. It is not authority for the proposition that, under the facts now before us, a surviving corporation is not liable as a transferee.

None of the other cases cited by petitioner involve any question of transferee liability or jurisdiction of the Court. *Adrian & James, Inc.*, 4 T.C. 708 (1945), and *Koppers Coal*

Co., 6 T.C. 1209 (1946), hold that a consolidating corporation may deduct interest paid by it on tax deficiencies of corporations consolidated with it. *Koppers Co. v. United States*, 134 F. Supp. 290 (Ct. Cl. 1955), certiorari denied 353 U.S. 983 (1957), deals with the question of whether a surviving corporation may carry back unused excess profits credits to reduce consolidated excess profits net income of merged corporations. *Stanton Brewery v. Commissioner*, 176 F. 2d 573 (C.A. 2, 1949), and *C. and J. Gallo Winery v. Commissioner*, 227 F. 2d 699 (C.A. 9, 1955), hold that excess profits tax credits may be carried forward where there is a merger, under the laws of New York and California, respectively. *New Market Manufacturing Co. v. United States*, 233 F. 2d 493 (C.A. 1, 1956), certiorari denied 353 U.S. 983 (1957), involved a net operating loss carryback to a prior year of a merged corporation.

Petitioner raises three other points. The first is that the insolvency of H. R. Henderson & Co. is an essential condition to the establishment of the Petitioner's transferee liability *at law*. We disagree. Where transferee liability at law is asserted, it is not necessary for the respondent to prove that the transferor was insolvent. See *Coffee Pot Holding Corp. v. Commissioner*, 113 F. 2d 415 (C.A. 5, 1940); and *Helvering v. Wheeling Mold & Foundry Co.*, 71 F. 2d 749 (C.A. 4, 1934).

Secondly, it is argued that the petitioner did not contract to "assume" or "promise to pay" any liabilities of H. R. Henderson & Co. Although it is true that the word "assumed" does not appear in the merger agreement, there is no sub-

stantial difference between an assumption of liabilities by the surviving corporation and an agreement by the survivor that all debts and liabilities of the merged corporation shall "attach" to the survivor as if incurred or contracted by it. Article XI of the merger agreement specifically provides, in pertinent part, as follows:

> All rights of creditors and all liens upon the property of any of the constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations, including liability to dissenting shareholders, shall thenceforth attach to the Surviving Corporation, and may be enforced against in to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

Moreover, the transferee agreement (Form 2045) provides that the petitioner "assumes and agrees to pay" the Federal tax liabilities of H. R. Henderson & Co. for the taxable years 1954 through 1956.

Finally, the petitioner contends that the transferee agreement is not binding because it lacks mutuality, having been signed only on behalf of the petitioner. The cases cited by petitioner, *Botany Worsted Mills v. United States*, 278 U.S. 282 (1929), and *Joyce v. Gentsch*, 141 F. 2d 891 (C.A. 6, 1941), are not in point because they involve final closing agreements, which are specifically required by statute to be signed on behalf of the Secretary or his delegate in order to have any effect. There is no such statutory requirement regarding the transferee agreement (Form 2045). Here the respondent promised, or agreed, not to issue a deficiency notice, or make an assessment against H. R. Henderson &

Co., at a time when respondent could have done so; and in return petitioner agreed that it was the transferee of assets of Henderson, and that it assumed and agreed to pay Henderson's tax to the extent of its liability under section 6901. Respondent fulfilled its part of the agreement. It did not issue a notice of deficiency to Henderson. Respondent's forbearance to act when it validly could have done so is sufficient consideration to support petitioner's promises. The agreement is no longer executory; it is executed and complete. Petitioner has received performance from respondent and cannot now properly repudiate the agreement.

Petitioner's motion to vacate the opinion filed on December 24, 1963, will be denied and an appropriate order entered.